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May 30 — June 5, 2011 | **businessweek.com**

Bloomberg Businessweek



The End of Mail

For 44¢, a government employee will take an ounce of paper from your house to the farthest reaches of Alaska. It's a noble American tradition—and on the verge of collapse. It doesn't have to be

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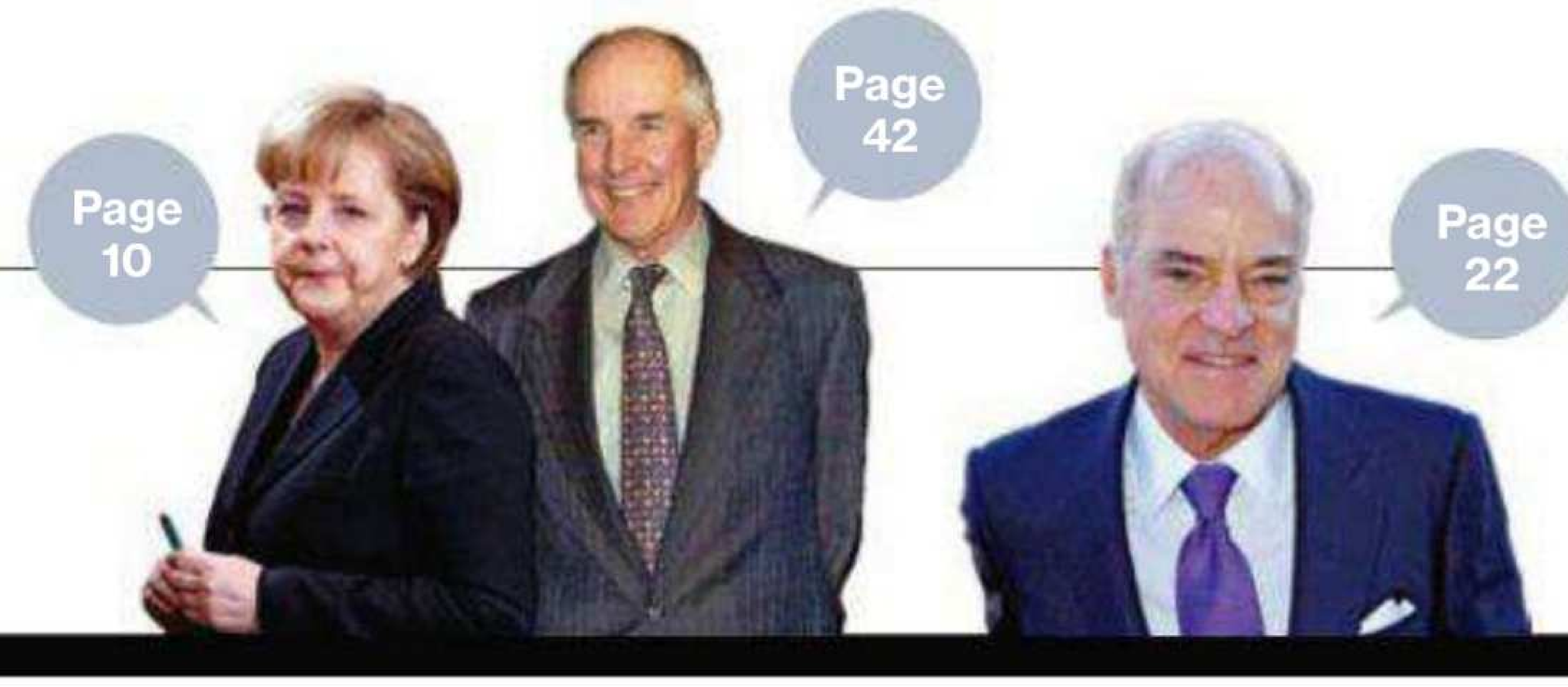
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Corrections & Clarifications

B In "What *l'Affaire DSK* Teaches the French" (Global Economics, May 23-29), Christopher Lee was identified as a former U.S. Representative from New Jersey. He represented New York.

B In "The Mastermind of Adrenaline Marketing" (Features, May 23-29), we incorrectly reported *Sports Illustrated*'s paid circulation. It has a verified weekly paid circulation of 2.91 million.

B "Tom Keene's EconoChat" (Global Economics, May 23-29) incorrectly quoted Goldman Sachs economist Andrew Tilton as saying that GDP in the U.S. would grow 3.5 percent in the first half of 2011. Mr. Tilton said GDP would grow 3.5 percent in the second quarter.

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Subscription Service PO Box 8418, Red Oak, IA 51591-1418
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Opening Remarks



Norquist (right) has a word with GOP Senator Orrin Hatch of Utah on Apr. 14

TOM WILLIAMS/ROLL CALL/GETTY IMAGES

The Enforcer

For decades, Grover Norquist has locked in lawmakers to oppose new taxes. The deficit debate is his greatest triumph—and biggest test

By Drake Bennett

A "campaign promise" is not exactly an oxymoron, but of all the pledges a person can make—wedding vow, blood oath, playground pinkie swear—it's the least dependable. Promises made with certainty a dozen times a day on the stump rarely survive their collision with the complications of actual governing. Ronald Reagan promised to slash the federal budget deficit. George W. Bush promised not to get involved in nation-building abroad. Barack Obama promised to close Guantanamo in his first year in office. They all sounded pretty good at the time.

Recent American politics has had one remarkable exception to the rule: the Taxpayer Protection Pledge. Administered by the Washington-based Americans for Tax Reform and created by the organization's founder, Grover Norquist, the pledge binds its takers to oppose "any and all efforts" to increase marginal income tax rates and to protect tax deductions and credits. Two hundred thirty-three of the 240 House Republicans have signed it, as have 40 of the 47 Republican senators. Two House Democrats and one Senate Democrat, Ben Nelson of Nebraska, are signatories, as well as 1,252 state legislators who signed a less specific pledge. All of which would be meaningless without the *omertà*-like fidelity with which pledge takers stick to their vows once in office. Any time a proposal is floated to increase taxes in any way—not just income taxes or trimming tax credits, but capital-gains taxes and even excise taxes on gasoline or tobacco—it's a safe bet that Norquist's army will line up against it.

As the federal government brushes against the debt ceiling, putting at risk everything from the nation's ability to provide prescription drugs for its seniors to a robust national defense, politicians on all sides agree that failure to reach a compromise could be catastrophic. Yet congressional Republicans have remained nearly monolithic in opposing tax increases as part of the solution. The deficit, they insist, must be closed entirely through spending cuts. It's a triumph for Norquist's pledge and the worldview it represents and reinforces: that govern-

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ment spending is, by its nature, a corrupting force on individual liberty and the free market, something to be fought whether the government is in the black or in the red. "Anyone who says we have a deficit problem is either a Democrat who wants to raise taxes," says Norquist, "or a Republican who's dimwitted and doesn't understand what he's talking about."

This moment is a triumph for the 54-year-old Norquist, too. For decades he's worked Congress and cable news studios to promote his single issue, promoting those who sign his pledge and punishing those who even consider breaking it. "He's a little bit like the old Roman emperor, turning the thumbs up and thumbs down," says Bruce Bartlett, a domestic policy adviser and Treasury official during the Reagan and George H.W. Bush Administrations. "He has an enormous amount of power, more than he's ever had before."

Yet even as it demonstrates Norquist's power, the budget crisis threatens to undermine him. In recent weeks, Norquist and his organization have engaged in a very public dispute with Dr. Tom A. Coburn (R-Okla.), perhaps the most uncompromising spending hawk in the U.S. Senate, over the senator's willingness to entertain tax revenue increases—not rate hikes, but the elimination of certain deductions and tax credits—as part of the so-called Gang of Six deficit deal. Coburn and GOP colleagues Saxby Chambliss of Georgia and Mike Crapo of Idaho have been negotiating with Senate Democrats on a potential compromise, and they have argued that the yawning budget gap is impossible to close with spending cuts alone. To Norquist, entertaining the idea of a tax increase at the very moment when the deficit is forcing Democrats to consider deep spending cuts is snatching defeat from the jaws of political victory. Who wins the argument will determine whether the current deficit debate is the apotheosis of Norquist and his pledge or the moment their influence begins to wane.

Grover Norquist has no real precedent in American politics. A single unelected actor with a single issue, he holds immense power over the Republican Party's fiscal platform, and, through it, the national policy debate. "I don't know of anyone outside of government who has had this kind of influence on politics before," writes Columbia University historian Alan Brinkley in an e-mail. "He's sui generis, I think, not a politician, not visible very often in the media, but remarkably powerful."

"He has an enormous amount of power, more than he's ever had before," says a former White House adviser

Norquist—who was raised in the Boston suburb of Weston, Mass., educated at Harvard University, and early in his career worked as an economist and speechwriter for the U.S. Chamber of Commerce—doesn't shy away from attention. He is a gifted polemicist, famous for insisting that he'd like to shrink government to the size "where I can drag it into the bathroom and drown it in the bathtub." His true influence, though, has been organizational. His Wednesday morning meetings at ATR's 12th Street offices are legendary in Washington. They bring together politicians and activists from all over the conservative movement: family-values campaigners and gun rights activists, military hawks, small-government libertarians, and corporate lobbyists. The meetings have helped to coordinate campaigns and instill a sense of esprit de corps among people who might not otherwise think to speak to each other. And in hosting the meetings, Norquist makes his cause the tent pole of that big tent.

"He knows that a lot of these issues have no chance on their own. Their only chance is if they're part of a package," says Bartlett, who used to attend the meetings but is now a critic of Norquist's unyielding stance. "You help people on some issues you may not have interest in or even agree with. In return, they support you on your issues."

Norquist drew up his pledge—a few lines on a single sheet of paper—in 1986. Two years later it blew up the race for the Republican Presidential nomination. In the New Hampshire Republican primary, then-front-runner Bob Dole refused to sign it and was steadily attacked by his rivals for holding out. George H.W. Bush, who had signed, came from behind to win New Hampshire and then the Presidency. Bush, of course, famously broke his promise once in office, raising taxes to deal with a budget deficit that would rise during his Presidency to 4.7 percent of gross domestic product. (Last year the deficit was just under 9 percent of GDP.) In so doing he incurred the wrath of Norquist and other conservative activists and lost crucial support during his failed 1992 reelection campaign. Thus the pledge was cemented as the one campaign promise politicians best make ironclad.

Over the years, Norquist has taken it upon himself to punish pledge breakers by organizing and fundraising for their opponents in Republican primaries. When reelection isn't looming, he hectors them. Asked about his disagreement with Coburn, he says, "He wants to raise taxes and he promised in a signed statement that he won't. I told him that he ought to keep his word."

Coburn, currently on a self-described "sabbatical" from the Gang of Six negotiations, thinks Norquist has hijacked the debate and imperiled the country. "We don't have the luxury of taking [Norquist's] position right now, because we can't solve our problem unless we get an agreement to trim spending," says Coburn. "Here's the thing I would say: If you're in Congress right now, and you allow somebody like Grover Norquist to tell you how to vote—you have an opportunity to really fix what's wrong with the country, and if instead you do what special interest groups say—you don't have any business being up here."

Coburn's argument touches on a larger criticism of Norquist's pledge, which is that a myopic focus on taxes actually allows elected officials to punt on spending. After all, today's deficit is largely the legacy of the Bush Administration's taste for simultaneous tax cuts and spending increases (future deficits will be increasingly dominated by Medicare and Social Security spending). Norquist sees it differently: Taxes and spending are two different things, he concedes. "But a politician who can raise taxes never discusses spending less." Ruling out tax increases "is a necessary but not sufficient condition to cutting spending."

Ultimately, for Norquist, the deficit is somewhat beside the point. The problem for him isn't government debt, it's government spending. "The deficit is the tip of the iceberg, it's the small thing on top of the bigger total spending," he says. Norquist's goal is to keep the temperature high enough so that the whole thing melts away. Ⓑ

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Bloomberg VIEW

Recalculating at the IMF ● How to Stop The Next Fukushima ● LinkedOut of IPOs

Bloomberg View is the new opinion section of Bloomberg News. Each week, *Bloomberg Businessweek* will run select editorials committed to an ideology of transparency and tolerance, nonpartisanship and intellectual honesty, free markets and data-driven solutions to global problems

The IMF's Electoral Math Doesn't Add Up

French Finance Minister Christine Lagarde, now a formal candidate to become the International Monetary Fund's next chief, enjoys decisive support and may well get the post. The chances of any non-European vaulting ahead of her were always remote, given that IMF voting power is tilted heavily in Europe's favor. For the good of the Fund, the next IMF boss should pledge to eliminate this inequity.

To see what's wrong with the electoral math, consider Belgium and Brazil. Belgium is the world's 20th-largest economy, with a 1.86 percent voting share in the IMF. Brazil is a vastly larger and more populous nation, ranked in the world's top 10 economies, with triple Belgium's output. At the IMF, however, Brazil is the weakling, with just 1.72 percent of the vote. China, the world's second-largest economy, ranks sixth in IMF voting power behind the U.S., Japan, Germany, France, and Britain. The IMF has been gradually realigning voting shares since 2006, and China is due to rise to No. 3 in voting power next year. That still lags economic reality.

The distortions date to the 1940s, when the developed world of Europe and the U.S. had most of the cash, know-how, and leadership. Under a gentleman's agreement among nations, the U.S. claimed the top job at the World Bank, which provides development aid, while Europe took the IMF, with its emphasis on government rescue loans and austerity plans.

Picking Lagarde keeps a well-connected European in charge of the half-finished work of resolving Greece's debt woes. Even if second-guessers think the IMF should have treated Greece more sternly last year, a radical switch in strategy now risks chaos. But changing fortunes demand an IMF that transcends its European past. Some $3 trillion of currency reserves, 31 percent of the global total, is held by China, according to Bloomberg News. Former IMF borrowers such as South Korea and Chile now sport single-A or double-A credit ratings. Singapore has a triple-A grade. By contrast, debt troubles in Europe have touched off a flurry of ratings cuts and IMF rescue loans. It's time for the IMF to reflect the new reality.

A Nuclear Disaster Agency That Knows No Borders

The Fukushima Dai-Ichi nuclear plant disaster keeps bringing new bulletins of unexpected trouble, including the disclosure by Tokyo Electric Power on May 23 that three reactors suffered fuel meltdowns in the early days of the crisis, suggesting that the accident was far more severe than previously acknowledged.

In the first few hours of the debacle, Japanese engineers struggled alone. One entity could have rallied world expertise in a hurry: the Vienna-based International Atomic Energy Agency.

The 2,300-person U.N. body has a 53-year history of involvement in all things nuclear. What's missing is a crisis fighter's mentality and a mandate to act. As the agency's chief, Yukiya Amano, conceded soon after the tsunami hit Japan, "We are not a nuclear safety watchdog."

From June 20-24 the IAEA will meet in Vienna to evaluate the consequences of Fukushima. Amano now acknowledges the need to move beyond "business as usual." At that meeting, the agency's chief should set a much bolder agenda, one that states that the IAEA will now:

- Help set mandatory standards for safe operation of the world's approximately 440 nuclear plants.
- Enforce those standards. The IAEA has won high marks for nuclear-plant inspections related to weapons-making concerns, even when it didn't find signs of trouble (such as its Iraq inspections in the Saddam Hussein era). As an independent agency free from industry pressures, it needs to bring that same zeal to safety.
- Improve rapid-response plans so that the best crisis experts can put their skills to work within hours of a major failure of reactor safety, wherever it occurs.

Investors Ought to Be Wary of LinkedIn

A share of stock is supposed to represent a claim on a company's future earnings. On May 19, LinkedIn's first trading day, the stock closed at $94.25, a jump of 109 percent from the $45 offering price, putting the company's market value at a stratospheric $9 billion. Although LinkedIn shares declined in the days after its initial public offering, they were still trading at more than 520 times 2010 earnings of $15.4 million. Considering that the company itself is warning that revenue growth is likely to decline this year—and that perennial highflier Google trades at a price-earnings ratio of 20—this level seems hard to justify.

Thirty million LinkedIn shares changed hands on May 19. That's 3.8 trades, on average, for each share

Individual investors should be particularly wary. Thirty million LinkedIn shares changed hands on the first trading day, meaning that each of the company's 7.8 million shares traded, on average, 3.8 times. Chances are that the smart money was buying and instantly selling to make a profit, leaving someone else—small investors?—holding the bag. Ⓑ

▶ *To read Ramesh Ponnuru on the GOP's chances in 2012 and Ronald Klain on Cabinet secretary chaos, go to: Bloomberg.com/view*

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PROBLEM

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AMERICA'S NATURAL GAS
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All price statistics taken from page 13 of the April 2011 edition of the US Department of Energy's "Clean Cities: Alternative Fuel Price Report."

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Global Economics

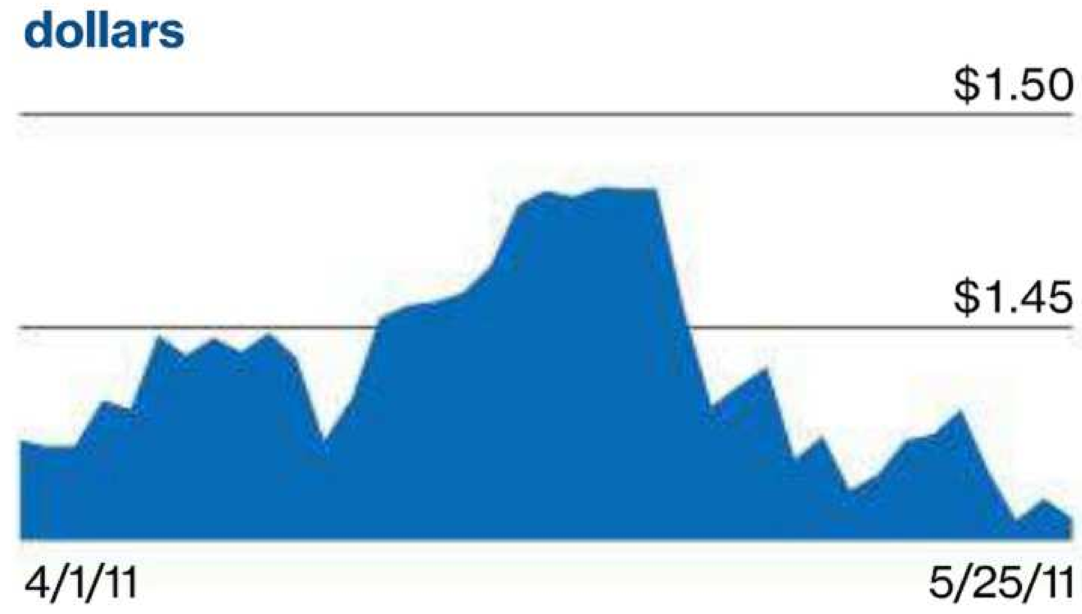
European Central Bank

On May 24, Christian Noyer of the ECB's Governing Council, described the idea of any debt restructuring as a "horror story." Big losses on Greek government bonds would devastate Greek banks and threaten the health of the ECB, which has been propping up Greece by investing in its debt. Worried investors are dumping the euro, which after rallying from a June 2010 low has dropped almost 5 percent since May 2.



Pressure on the euro

Value of euro in dollars



U.S.

If a debt crisis drives Europe back into a recession, companies will lose a key export market, banks will suffer losses, and the dollar will rise, making American goods less competitive.



Greece: Why the Beast Is Back

▶ **Europe's banks aren't ready for losses should Greece default**

▶ **Extend and pretend throws good money after bad**

It's looking more and more likely that the Greek government will eventually fail to make payments on its bonds on time and in full—in other words, default is looming. Traders put a more than 70 percent probability on a Greek sovereign default some time in the next five years, judging from the prices they're paying for protection in the credit-default swap market. The question of the hour: Should Europe keep fighting to postpone the inevitable or begin arranging for an "orderly" default that causes the least possible collateral damage?

The case for delaying a default is that European banks need more time to repair balance sheets that were devastated by the 2007-09 financial crisis. The profits they're earning now are rebuilding their capital. The longer that Greece can be kept afloat, the better Europe's banks will be able to withstand the losses they'll be forced to recognize if Greece goes under. European banks and the European Central Bank have a strong incentive to extend and pretend.

Those who favor a default now say that European governments—and hence, ordinary taxpayers—are throwing good money after bad by extending fresh credit to Greece to keep it afloat. They point to Uruguay's 2003 restructuring, which extended bond maturities by five years at the original interest rates, as a success story. New York University economist Nouriel Roubini has been pounding the table for a Greek debt restructuring since last June.

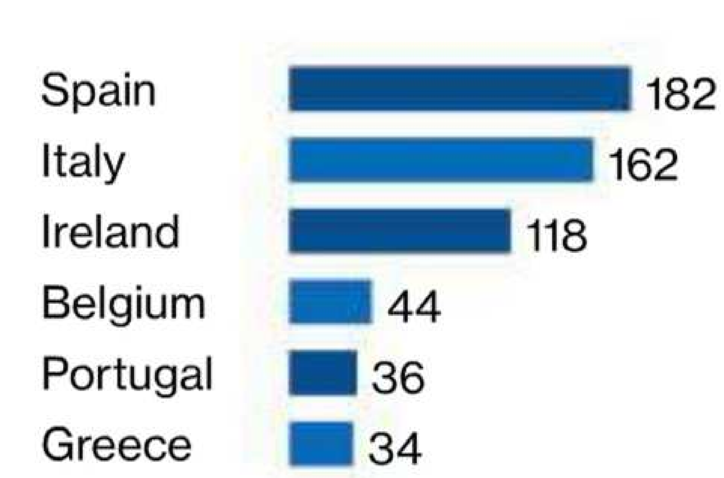
Greece's problems are much worse than Uruguay's, so the haircut suffered by banks and other creditors would have to be deeper. But let's be clear: The damage from bad policy has already been done. There is no painless way out of Europe's mess. —*Peter Coy*

Germany

The Germans have loudly criticized the Greeks for not keeping up their end of the bargain and don't want to extend more loans to the country. Chancellor Angela Merkel's party was recently beaten badly in a state election in part because of her support for the bailout. The German government, despite its misgivings, will probably go along with another loan package to Greece.

Overexposed

German banks' holdings of each nation's loans and bonds (billions of dollars) in Dec. 2010



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European Union

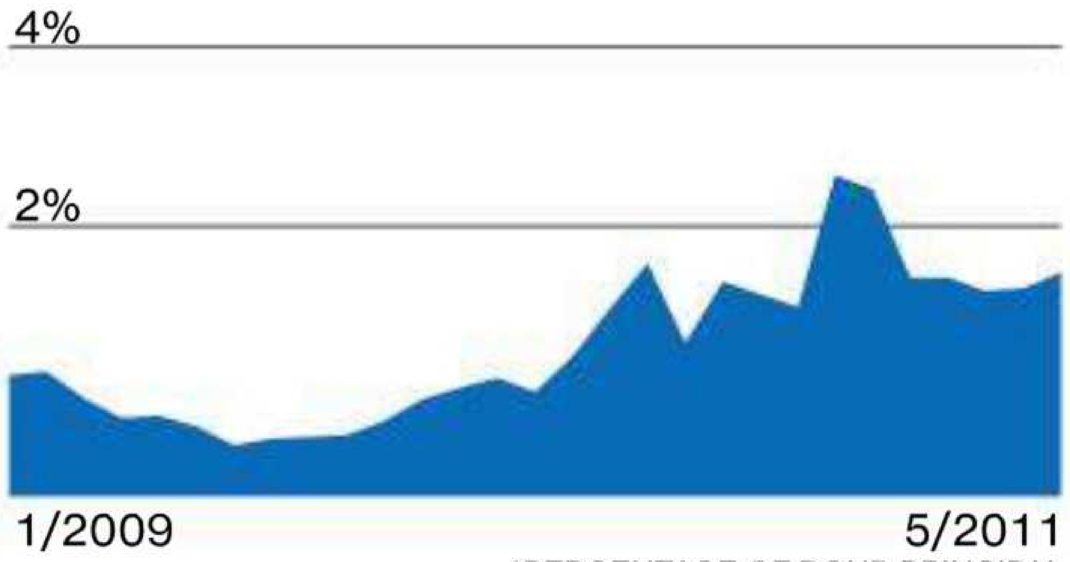
German Finance Minister Wolfgang Schäuble triggered the current crisis on Apr. 14 by suggesting the Greeks might need to restructure their debt. A month later, Luxembourg Prime Minister Jean-Claude Juncker (above) suggested a "reprofiling" of the debt that would stretch out payments. Ratings agency Fitch says it will consider any of these moves a default. Greek 10-year bonds now yield 16.5 percent.

Spain and Italy

Spain and Italy are pressuring Greece to fix its problems, worried that a Greek default will cast doubt on their own creditworthiness. Spain's borrowing costs have already risen. The ruling Socialist Party, which has been imposing austerity, suffered a record loss in local elections on May 22. Meanwhile, ratings agency Standard & Poor's has warned it may downgrade Italian debt.

Spain's Pains

Annual cost of protection against sovereign default for five years*



*PERCENTAGE OF BOND PRINCIPAL



START

Greece

After getting €110 billion ($155 billion) in aid last May from the European Union and the International Monetary Fund, the Greek government launched an ambitious deficit-cutting program. Though it made progress last year, the effort has begun to stall. Government revenues for the main budget fell 9.2 percent in the first four months of 2011 from the year before—a dire sign, considering that the Greeks had hoped to raise revenue 8.5 percent for all of 2011. Now an infusion of loans from the EU seems likely, in exchange for Greek promises to cut an additional €6 billion out of the budget and sell off €50 billion in state assets, such as its phone company.

Speculators

Early buyers of credit-default swaps, a kind of insurance on Greek debt, could make a killing if the government defaults. The contracts entitle them to receive the Greek bonds' full face value.

Irish PM Enda Kenna



Ireland and Portugal

If Greece defaults, these two countries on the periphery of Western Europe will have a hard time convincing investors that they won't be next. Protecting their sovereign debt against default for five years costs about 6.7 percent a year, vs. almost 15 percent for Greece.

When the bill will come due

Due dates of principal and interest on Greek government bonds and loans (in euros)



Slipping ratings

Greece's credit rating has dropped precipitously

Jan.	2009	A-
Dec.	2009	BBB+
Apr.	2010	BB+
Mar.	2011	BB-
May	2011	B

European Banks

€95b

Moody's Investors Service estimates that European banks hold about €95 billion in Greek sovereign and private debt—and could lose one-third of it in a worst-case scenario. The real bank crisis would occur if a Greek contagion effect caused Portugal, Ireland, or even Spain to default. Europe's banks hold some €630 billion in Spanish debt alone. Not surprisingly, the banks want Greece to pay its debts in full and on time. European bank stocks are trailing European stocks.

Crushed in the stock market

European bank stocks have fallen more than a broad index of European stocks

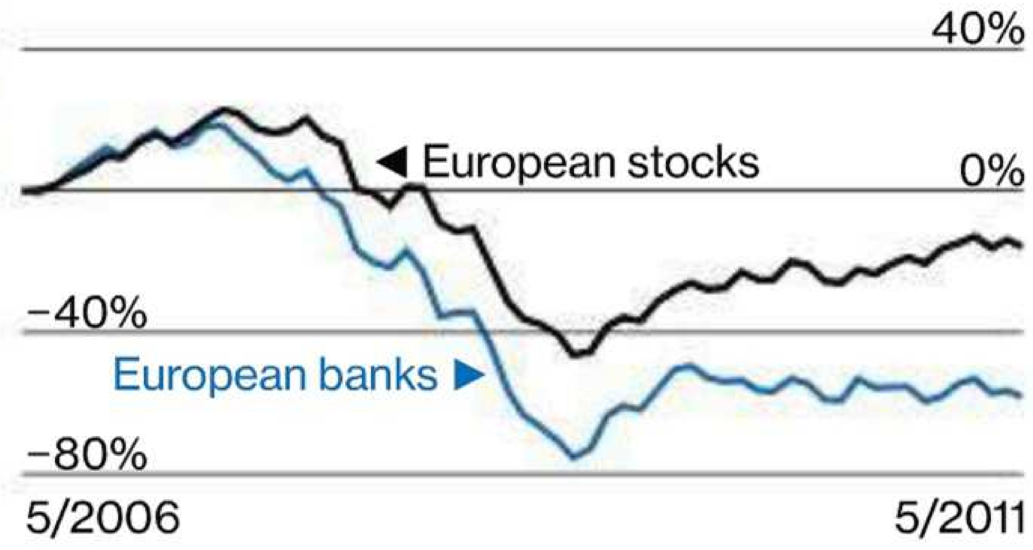


ILLUSTRATION BY NOMA BAR; TBLOOMBERG (3); DATA: EURO: BLOOMBERG; GERMAN BANKS: BANK FOR INTERNATIONAL SETTLEMENTS; GREEK BONDS: BLOOMBERG; GREEK CREDIT RATINGS: STANDARD & POOR'S; SPANISH DEFAULT SWAPS: CMA; EUROPEAN BANK STOCKS: BLOOMBERG LP

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Barges along the swollen river early in May

Shipping

Trade Slows as the 'Old Girl' Gets Ornery

▶ A Mississippi pilot confronts a flooded river as he moves ships

▶ "On the river, if you screw up someone can get killed"

The first signs that Captain Cory F. Heitmeier was in for an unsettling day's work on the Mississippi came before he even boarded a boat on May 17. At the dock where the river pilot waited to catch a crewboat to a Panamanian-flagged freighter, a paved driveway was already covered with floodwater. Gravel had been poured on top to make a makeshift road.

Heitmeier and his fellow pilots help guide the 448 million tons of cargo that pass through the mouth of the Mississippi each year. On the best of days, the job is tricky. The fourth-longest river on the planet is full of shifting currents, submerged hazards, and constant traffic. As rain and snow flowed down from the north, the river at New Orleans crested the day before Heitmeier met the freighter. His job had become treacherous. "On the river, if you screw up, someone can get killed or you can wipe out an entire population," he says.

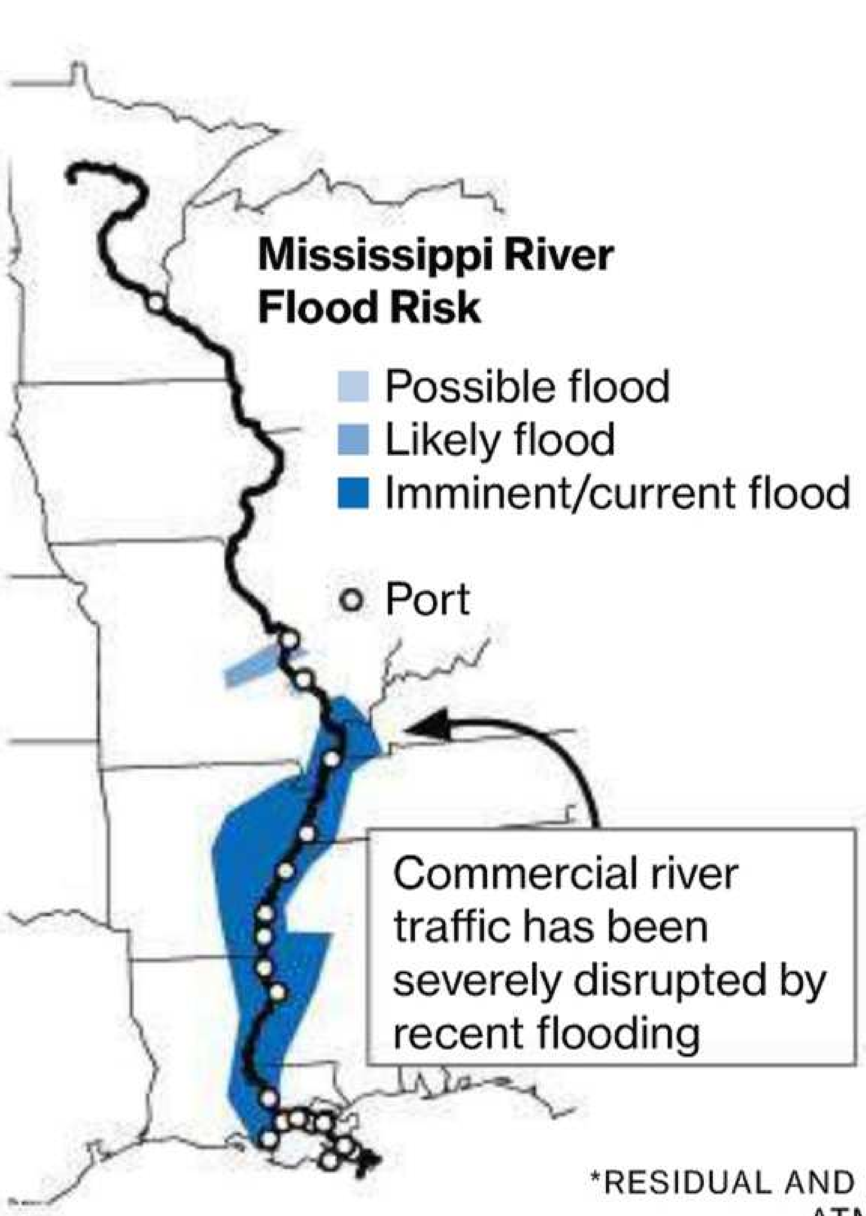
Historic flooding has limited the amount of freight moving along the Mississippi. The river and its connecting waterways are home to 20,500 barges, according to a 2010 report by Informa Economics, a Memphis research firm. Much of the rest of the traffic on the river comes from tankers and cargo ships moving from the Gulf of Mexico and out to the rest of the world. Cargo passing through the Port of New Orleans, part of the stretch of river Heitmeier works, accounts for about $37 billion of national economic output every year, says Chris Bonura, a port spokesperson. About 60 percent of all U.S. grain exports are shipped on the Mississippi through the Port of New Orleans and the Port of South Louisiana, according to the U.S. National Park Service.

Water this high breaks any workaday routine on the river. Normally, a towboat might push 30 to 40 barges up the river at a time, with each weighing from 1,200 to 1,500 tons, says Steve Jones, navigation manager for the Army Corps of Engineer's Mississippi Valley Division. Conditions have cut that number to about 20 barges. The risks to ships on what river pilots call the "Old Girl" are both financial and human. Tankers carry everything from oil to toxic chemicals. A spill could be catastrophic to crews and towns. A ship breaking into levees could cause disastrous flooding. "Some of these things are floating bo–," Heitmeier says, stopping short of the word bombs. "I don't even like to think of it."

Pilots know every nook and cranny of the river. To get his license Heitmeier, a 10-year veteran, had to draw in detail the 147 miles (237 kilometers) of the river he would be working on. The ship he pilots today is the *Federal Baffin*, a bulk carrier longer than two football fields that has taken a load of potash fertilizer on a 22-day journey from Russia. The freighter, equipped with four cranes

The Mississippi and the Economy

Vital commodities travel the Mississippi River system to markets both inside and outside the U.S.

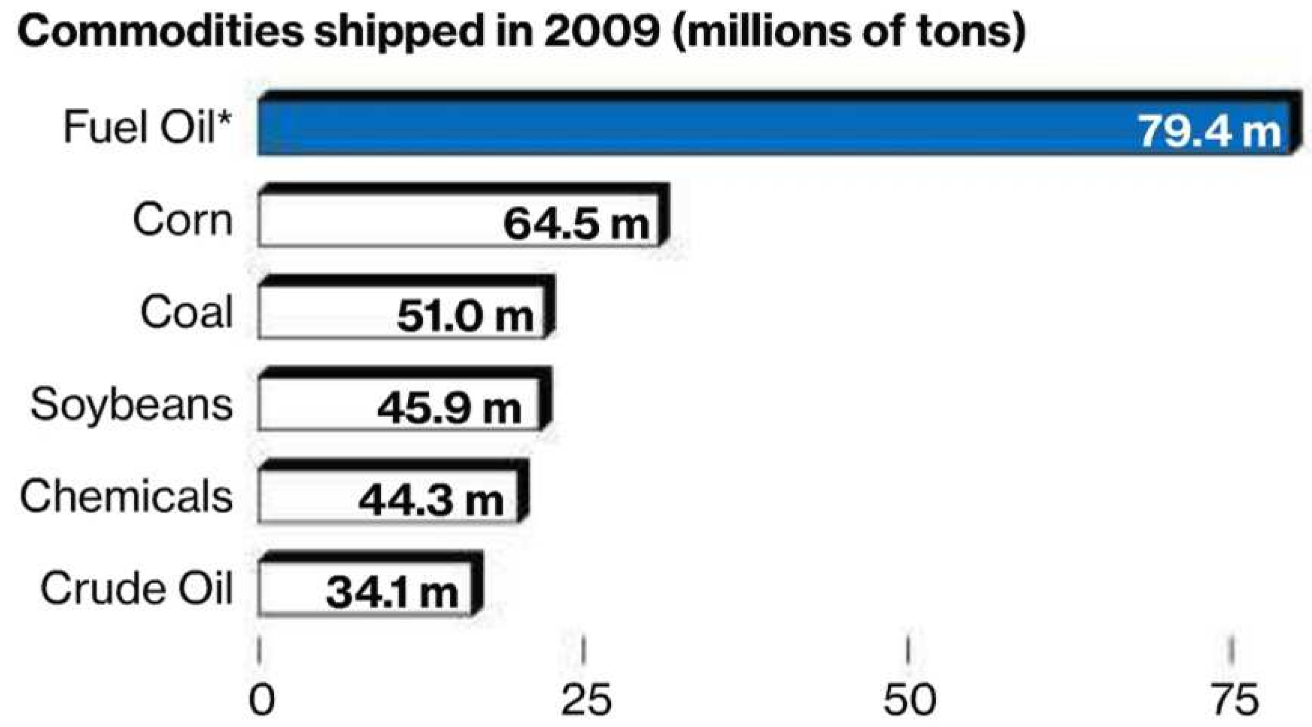


600 Barges on the river per day, on average

447.7 m tons of commodities shipped on the river in 2009

176.3 b miles traveled by all river cargo in 2009

Commodities shipped in 2009 (millions of tons)



*RESIDUAL AND DISTILLATE. DATA: U.S. ARMY CORPS OF ENGINEERS, NATIONAL OCEANIC AND ATMOSPHERIC ADMINISTRATION, WATERBORNE COMMERCE STATISTICS CENTER

CLOCKWISE FROM TOP LEFT: ROBERT KING/POLARIS; NICK FERRARI; JONATHAN ALCORN/BLOOMBERG

Apparel makers are snipping costs page 18 ▶





and a helicopter pad, will pick up a load of gravel for a 31-day sail to Japan. The crewboat carrying Heitmeier nuzzles up to what looks, up close, like the side of a steel building. Heitmeier waits for the crewboat to rise on a wave before hopping onto a metal staircase hanging over the ship's side. Wearing khaki pants and a blue madras button-down Brooks Brothers shirt, the 37-year-old looks like a banker on casual Friday. He will guide the ship from its anchorage and navigate it four miles upriver, where it will be tied to buoys and unloaded. "This is one of the most dangerous things we do," he says. Especially now. "Just how high the damned thing is. How fast it's moving."

Once on the bridge, Heitmeier is in charge–even the ship's captain will answer to him. Communication will be tricky. The captain, a Chinese national, speaks broken English. The chief mate below, who coordinates the anchors and other rigging, speaks Russian. Heitmeier already anticipates that the commands "starboard 10" (turn right 10 degrees) and "stop engine" will be misunderstood. He sets up a laptop with satellite navigation software that shows a detailed schematic of the river and traffic. From the bridge, Heitmeier is higher than the treeline on either side of the river, which laps mere feet from the top of the levees. Dozens of barges are tied down on both banks.

Boats must take water into their hulls as ballast so they can sit lower in the river to clear bridges, making them even slower to respond to rudder controls. Ships going upriver cruise more slowly against the current even as they use more power to compensate, leaving less power for emergency maneuvers. "With the river like this, you have to be on top of it," Heitmeier says. "One minor little thing that you overlook can cause everything to go wrong."

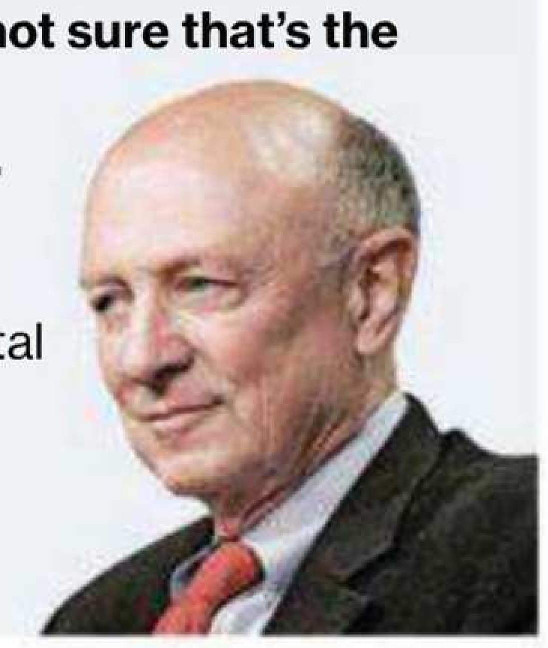
Once under way, it isn't long before the language barrier causes problems. Nearing a turn, Heitmeier calls out "hard to starboard" for a right turn. The second mate repeats the command, yet the quartermaster turns the rudder wheel left. Seeing the error on a compass above, Heitmeier commands "midship," asking for the rudder to be centered. Once again, the quartermaster turns the wheel hard left to the port side of the ship.

Heitmeier snaps his fingers as he barks to the captain to boost the ship's power to "sea speed," used on the ocean yet normally held in reserve on the river. The captain is slow to respond, prompting Heitmeier to snap his fingers louder. "Sea speed, captain. Emergency sea speed, now." The extra power pushes the ship back onto course and away from a line of barges tied to a dock. Heitmeier orders the quartermaster replaced. "That's only the second time in my career that I've had to order the quartermaster changed," he says. Proof, this is no ordinary week on the Mississippi. *—Duane D. Stanford*

***The bottom line** Delivery times for shipments of grain and other valuable commodities are slowing as floods raise the level of the Mississippi.*

Quoted

"I kind of miss the Soviets. They were at least just thugs with a cover story. They weren't fanatics and could be negotiated with. I'm not sure that's the situation with Iran."
—R. James Woolsey, former CIA director and currently venture partner with Lex Capital Management



Labor

Scarce Talent, Rising Wages, Balky Clients

▶ India's outsourcing companies are struggling to preserve their edge

▶ "Suddenly there was a huge shortage of people"

In India, of all places, how could outsourcing companies be struggling with a labor shortage? The country has over 1.2 billion people, and the industry has boomed, thanks largely to its abundance of inexpensive and English-speaking workers.

The numbers can be misleading, warns Krishnakumar Natarajan, chief executive of Bangalore-based outsourcing company **MindTree**. There are 400,000 engineers entering the workforce each year, he says, "but the fact is, only 20 percent of them are industry-ready." And competition for experienced workers is heating up since cutbacks during the financial crisis resulted in fewer newcomers to the industry. "During the recession, nobody recruited," he says. When business revived last year, "suddenly there was a huge shortage of people."

With demand so high, churn rates have increased from the traditional level of 12 percent of all IT employees to 17 percent now, according to Nasscom, the New Delhi-based industry association for IT services companies. Call centers and other basic services are seeing attrition rates of 55 percent, up from 40 percent a year ago, according to an April report from the Associated Chambers of Commerce & Industry of India (Assocham). High attrition rates "might prove to be fatal for the survival and growth of India's business-processing outsourcing sector," says Assocham Secretary General D.S. Rawat.

Nasscom President Som Mittal expects wage increases for new hires will be as high as 12 percent this year. More significant, he adds, experienced workers jumping to other jobs "expect 15 to 20 to 25 percent increases." Case in point: Divya Bajaj, a 25-year-old who lives in Bangalore. Bajaj used to work at **Google** and last year joined **Infosys Technologies**–with a 30 percent

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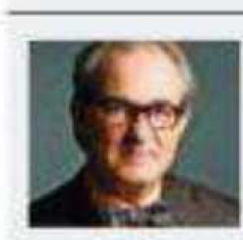
Tom Keene's EconoChat

Tom talks with MIT economics professor **Simon Johnson** about crises, central banks, and moral hazard.

The HBO version of *Too Big to Fail* just came out. What are we forgetting about the bank crisis of two to three years ago?
I think we are forgetting how much Mr. Paulson and the Treasury opposed any kind of preemptive measures and action. You know, the FDIC has a paper out saying they could have used the Dodd-Frank powers if it had them in the day to deal with Lehman six months before the crisis. I don't believe that is true, because I know from my own experience how steadfastly opposed the Treasury team was to anything at all getting ahead of the curve. That is not their mindset. It is all about muddling through.

Is your reading of history that we used to not muddle like that?
We have always muddled. But the extent to which we have built up moral hazard and encouraged creditors not to be careful, I think that has gone way beyond what is acceptable. We are still dealing with the breakdown of Bretton Woods. We lost our anchor. We tried to replace it with central bank credibility, but only to the extent central banks looked the other way from financial sector excesses.

What is the new anchor?
I don't think we have one. You cannot go back to gold. It is just not practical. You can have central banks that will keep to a zero to 4 percent inflation target. But how do you square that with the consequences for the financial sector, which we see again in Europe and around the world? Ⓑ



Keene hosts Bloomberg Surveillance *7-10 a.m. ET on 1130AM in New York and nationally on SiriusXM 113.*

increase in pay. "Costs are going up," says Sudin Apte, chief executive of Pune-based consulting firm Offshore Insights Research & Solutions, "but clients don't want to pay more." Five years ago typical profitability for an Indian outsourcing firm was 30 to 35 percent, according to Apte. Now it's down to 20 to 25 percent for the top providers and as low as 10 to 12 percent for lesser companies. "In the next five years," he says, "it will go down another three, four percentage points."

In the lingo of Indian industry, many of these companies rely on "linear" growth—they increase revenues by increasing head counts. More workers, more business. As Indian workers become pricier, this model may grow obsolete, given the availability of talent in Southeast Asia and other inexpensive locations. There, low-cost rivals "could definitely be a threat" to the Indians, says Praveen Bhadada, manager of **Zinnov Management Consulting** in Bangalore.

Tata Consultancy Services (TCS), India's largest IT services company, with $8.2 billion in revenue for its latest fiscal year, is trying to develop more of a nonlinear model. The company wants to standardize some software and services it has developed and sell them to customers more aggressively. For instance, last year TCS started offering a cloud-computing service to small and midsize customers, says Vish Iyer, head of Asia-Pacific operations. The goal is "leveraging our intellectual property, not leveraging our head count," he says.

Yet even TCS still gets more than 90 percent of revenues the old-fashioned way, by adding bodies. "The needle won't shift very quickly," Iyer concedes. "But it will." The company is also diversifying, opening offices in 41 other countries, including China and the Philippines.

Bangalore and other Indian cities still maintain many advantages. "There are no other locations where you can get such a large-scale head count for export work," says Apte of Offshore Insight. Still, he adds, a change is taking place. While India has between 75 and 80 percent of the market today, by 2015 that share is likely to fall by 10 percentage points.
—Bruce Einhorn, with Jay Shankar

The bottom line *Margins for Indian outsourcers have dropped as wages rise and attrition has reached 55 percent. Clients resist paying more.*

Indicators

In Brazil, a Bikini Wax Is More Than a Bikini Wax



▶ The cosmetic procedure is one of the services used to gauge prices

▶ "Services will continue to be the main villain of inflation"

If you're getting a bikini wax in Brazil, you'll likely find that the cost is rising. And if you're an economic policy maker, you'll likely see that as a problem, since the bikini wax is one of the items the Brazilians track to figure out inflation.

As with services ranging from car repair to dentistry, the price of waxing is going up in one of the world's most important emerging markets. Inflation is moving above the government's target and may force Alexandre Tombini, the central bank president, to prolong his policy of interest-rate hikes.

Price increases for services, which make up 24.1 percent of Brazil's benchmark inflation index, outpaced all other categories in the past two months, according to data released on May 11 by the central bank. They rose 8.57 percent in the year through April, the fastest pace in at least 15 years. "Services will continue to be the main villain of inflation," says Fernando Fix, chief economist at Votorantim Wealth Management in São Paulo. "Domestic demand is too strong."

That includes demand for bikini waxes, which are often considered a necessity, says Elzimar Siqueira, former owner of a beauty shop and now head of administrative affairs at the Syndicate of Women's Beauty and Hairdressing Institutes of Rio de Janeiro. "We have summer all year, we're always wearing bikinis and miniskirts," she says. At the Imaculada Hair and Makeup shop in Brasilia, owner Alessandra Rita de Arruda Lopes says she's raised the

FROM TOP: THALES STADLER/AGENCIA ESTADO/ZUMAPRESS; ANDREW HARRER/BLOOMBERG


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We all have an investment in fighting climate change.
As one of the world's foremost climate change investors, Deutsche Bank's Asset Management division is a leader in ideas, research and investment strategies that enable our clients to identify and channel capital towards companies that will help the world to mitigate and adapt to the shifting climate.
The financial potential is significant – the environmental rewards incalculable.
Passion to Perform
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Global Economics

price to 35 reais ($21.63) from 30 reais. The average price of the depilation procedure rose 12.4 percent in the year through April, the national statistics agency says. A bikini wax at J. Sisters in Manhattan costs $75.

Consumer price increases in Latin America's biggest economy breached the government's 6.5 percent target ceiling in the year through April for the first time since June 2005. The benchmark interest rate has now reached 12 percent, and economists expect the central bank to boost it to 12.5 percent by year-end, a recent survey showed.

Gross domestic product per capita reached a record $10,813 last year, after the economy grew 7.5 percent, the fastest pace in more than two decades. Such growth boosts demand for services. Also contributing to higher prices is a tight labor market, which drives wages up. Wages may be bumped up again after collective bargaining late this year and next, says Constantin Jancso, an economic analyst at São Paulo-based HSBC Bank Brasil. "Negotiations with metalworkers and bankers begin in the third quarter," he says. "I wouldn't be surprised to see increases of 10 percent."

Prices of 20 of 41 services monitored by the central bank accelerated in April from March. Oil changes and car cleaning prices rose 18.25 percent in the year through April. Hotels increased prices by 14.03 percent.

Price hikes in Brazil are also spurred by indexation, in which past inflation is used as a benchmark for raising prices. The minimum wage, for example, is computed annually by adding the previous year's inflation to economic growth from two years back. In 2012 the minimum wage will likely go up more than 13 percent.

Higher wages are one reason beauty shop owner Lopes is raising prices. Meal vouchers, cosmetics, and the cost of "depi rolls," which are used to spread the wax for depilation, are also rising, she says. "Some clients are coming less frequently for haircuts because of the higher price," she says. "But not for waxing. Brazilian women will never stop getting waxed." B

—Iuri Dantas

***The bottom line** Services from bikini waxes to car repairs are getting pricier in Brazil, prompting fears of higher inflation and higher wages.*

Seven Days

Events of note in the week ahead

by Ira Boudway

30

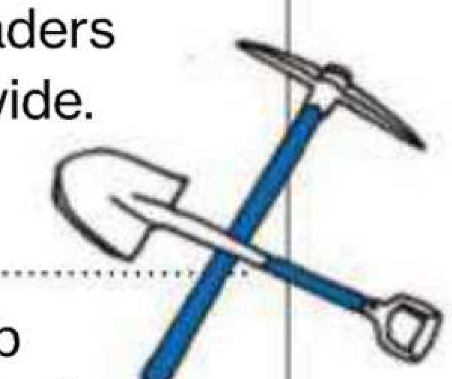


Japan's housing starts and industrial production

Germany's retail sales

▶ **Memorial Day:** Markets close as the U.S. honors men and women who died in military service.

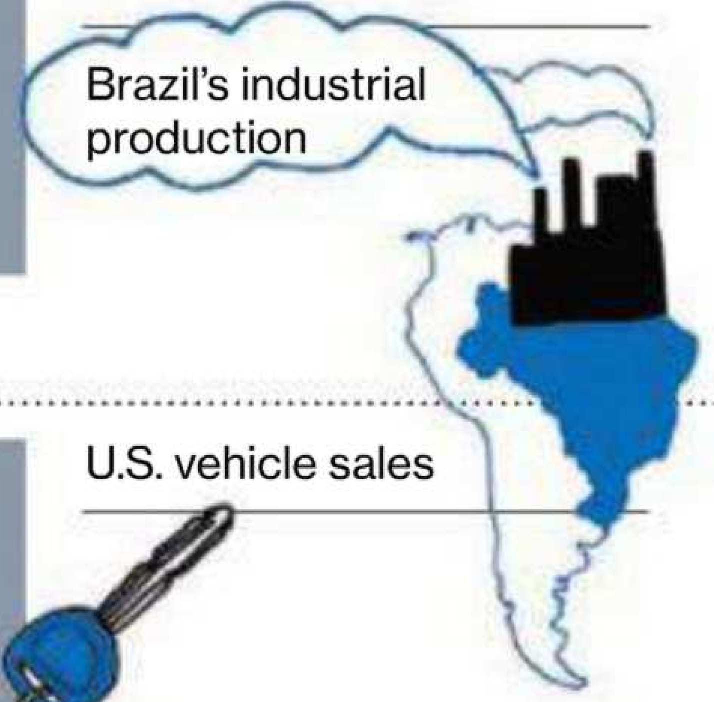
▶ **Miners strike in Peru:** In a push for new labor legislation, union leaders call for a halt in mining nationwide.



31

German Chancellor Angela Merkel visits New Delhi

Brazil's industrial production



▶ **U.S. consumer confidence:** Job growth drove a 2 percent gain in the Conference Board's index in April. Surveyed economists expect a smaller increase for May.

01

U.S. vehicle sales

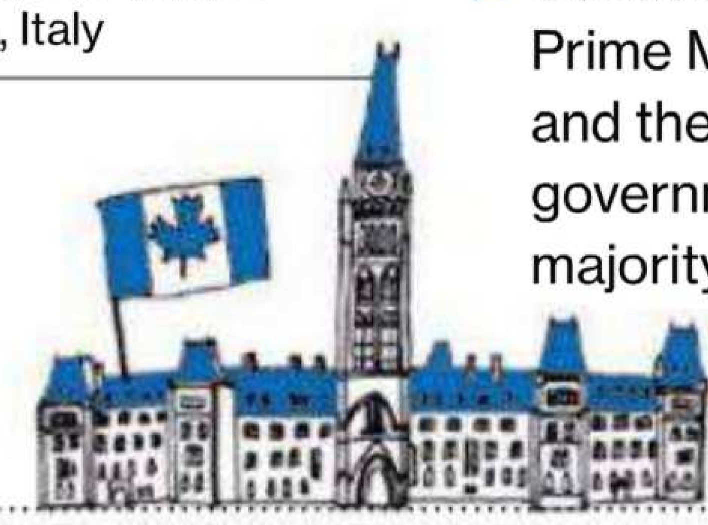


▶ **Hurricane season begins:** The National Ocean and Atmospheric Administration predicts above average activity in the Atlantic, with 12 to 18 named storms and 3 to 6 major hurricanes.



02

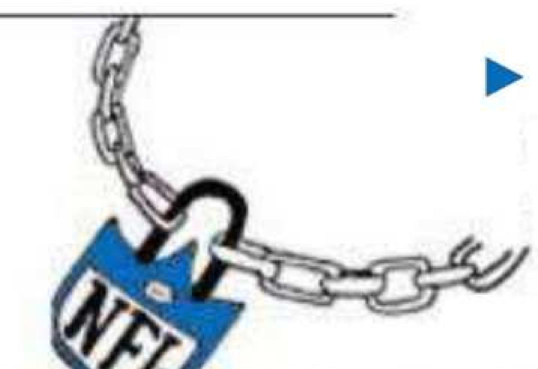
Festival of Economics in Trento, Italy



▶ **Canada's Parliament back in session:** Prime Minister Stephen Harper and the newly reelected Conservative government begin work with a majority mandate.

03

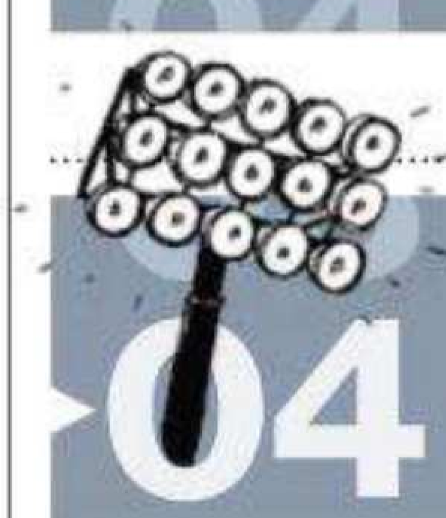
GOP hopefuls gather at the Faith & Freedom Coalition Conference



▶ **U.S. unemployment:** Surveyed economists expect the jobless rate to fall from 9 percent to 8.9 percent.

▶ **NFL lockout:** The appellate court that upheld the owners' lockout in May hears the players' appeal.

04



Soccer: The U.S. team faces World Cup champ Spain at Gillette Stadium

▶ **Venice Biennale:** The six-month international art exhibition begins. More than 80 countries will participate, including first-timers Andorra, Saudi Arabia, Bangladesh, and Haiti.



05

Presidential election in Peru



▶ **Palestinian unrest:** To mark the 44th anniversary of the Six-Day War, Palestinians plan a second round of protests on Israel's borders with Syria, Lebanon, and Gaza.

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ILLUSTRATION BY JULIA ROTHMAN

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Smarter business for a Smarter Planet:

Making the fastest people in the city of Madrid 25% faster.

To put emergency responders on the scene as quickly as possible, you need more than fast cars and good radios. You need to orchestrate absolutely everything about the organization, synching not just the people from the different agencies—fire, ambulance, police and traffic agents—but all the processes and technology that serve them as well. The city of Madrid did just that—with help from an IBM business process management solution that integrates the disparate applications, data and processes of its different agencies. Since implementing this solution, the city has reduced Madrid's emergency response time by 25%.

A smarter city is built on smarter software, systems and services.
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A data visualization of emergency incidents in Madrid between 2009 and 2010

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Why 'Less Is More' Rules Fashion

▶ **Apparel makers tweak clothing designs to snip and trim costs**

▶ **"Would dropping the watch pocket redefine this pair of pants? I don't think so"**

When **Gap** was forced to slash its 2011 profit forecast by 22 percent on May 19, Chief Executive Officer Glenn Murphy blamed soaring cotton and labor costs. Retailers from **Target** to **Family Dollar Stores** have cited similar margin-squeezing pressures. All of this came as a shock to apparel company executives, many of whom have experienced only stable or falling costs for the past 20 years.

Retailers realize that they don't have much pricing power with budget-conscious consumers these days. That's why apparel makers are turning to "deconstruction" experts like Peter Brown, who shows clients how to tear garments apart and put them back together with cheaper and fewer materials. Companies are loath to talk about their cost-cutting for fear of damaging relationships with consumers. "They're working through this minefield," says Brown, who is the vice-chairman of retail consulting firm **Kurt Salmon** and says he works with most of the big clothing makers and sellers.

Brown is currently working with garment makers that will ship to stores in July 2012. (He declines to identify his clients.) There's a fair amount of nipping and tucking to be done, he says, because Kurt Salmon anticipates costs surging as much as 15 percent in the second half of this year.



PHOTOGRAPHS BY NICK FERRARI FOR BLOOMBERG BUSINESSWEEK

Because only so much can be cut out of a garment, cost savings amount to a few pennies here, a few pennies there: eliminating cuffs and pleats, scrimping on linings inside coats, switching to coarser material for pockets. Fabric comprises as much as 50 percent of a garment's costs. Cutting it more carefully to reduce waste can reduce by 50¢ or more the cost of a pair of $195 men's wool dress slacks, Brown says. Zippers that come in a big roll are cheaper than ones custom-made for specific garments.

"For big apparel companies that make hundreds of thousands of men's suits a year, saving 20¢ or 50¢ a garment is a lot of money," says Salvatore Giardina, a men's suit designer and adjunct professor at the Fashion Institute of Technology in New York. Brown recently examined a pair of men's khakis that sell for $29.50 and spotted a coin pocket. Eliminating it zaps a nickel, he says. Watch pockets are an easy cut, since few men use them anymore. So are logos and decorative stitching inside the waistband—visible to men only when they put on their pants.

There's an art to this, designers say, at a time when many shoppers are watching their budgets. Consumers notice fixes that go too far. One no-no, says Giardina: making pants' pockets so shallow that loose change escapes. A simpler waistband with less material and stitching can make the top of a pair of slacks roll over. Switching to plastic buttons that crack after a few washings and using coarser wool can send shoppers elsewhere, says Giardina.

For "companies that make hundreds of thousands of men's suits a year, saving 20¢ to 50¢ a garment is a lot"

Most garment manufacturers take care to make changes that won't be spotted easily by consumers, according to Brown. "It's not the objective of any designer to say, 'How cheaply can we make these things?'" he says. "Most retailers don't want to cheapen the product. They're asking, 'Would dropping the watch pocket redefine this pair of pants? I don't think so. So knock off the watch pocket.'" In some cases, fashion trends can make life easier. The slim silhouette favored in suits and shirts by young men (and older hipsters), for instance, saves a lot of fabric.

Still, Brown says, the inflationary environment is exacerbating the usual tension between designers, who want to produce beautiful clothes, and manufacturers and apparel executives, who want nice togs with nice profit margins. "On one side of the table, you've got a designer who says, 'You can't destroy my beautiful product by lopping the watch pocket off,'" says Brown. "On the other side, you've got the manufacturing executive saying, 'You say you want to keep these things under $30. Tell me what you want to do.'"

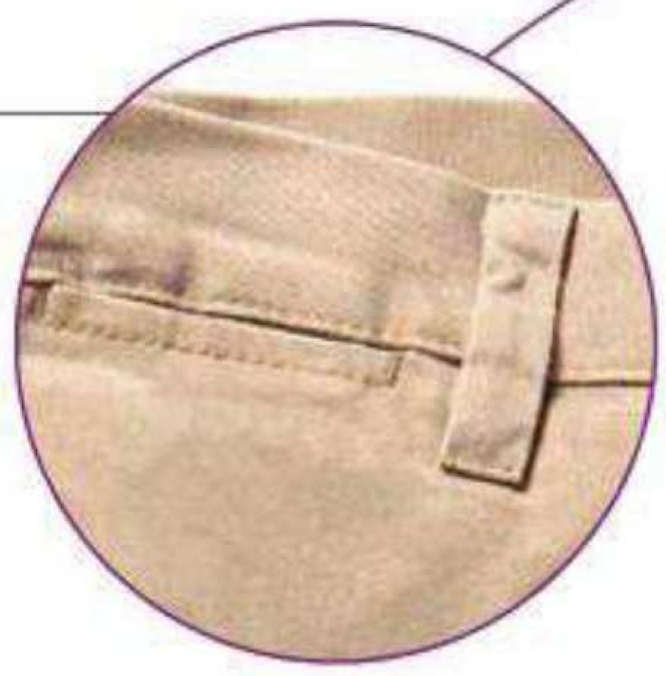
Recently, Giardina's sister, Concetta, who is a button sales representative in New York, met with production managers from a major retailer to discuss the cost of a men's dress shirt that will appear in stores next spring. Did they want real shell buttons or imitation pearl? Concetta asked. "What's the price difference?" Concetta recalled them inquiring. About 20¢ a button for shirts that would need a dozen of them, she said. They took the imitation. —*Chris Burritt*

The bottom line *With fabric and labor costs projected to grow 15 percent in the second half of 2011, apparel makers are redesigning clothing to extract savings.*

WorldMags



The waistband
A two-piece waistband is cheaper than the four-piece type with interior stabilizers found on pricier slacks



Belt loops and coin pockets
Fancy set-in belt loops and coin pockets, little used these days, require extra work to sew—raising costs. Few shoppers miss them

Buttons and zipper
Buttons are cheaper than a metal hook and bar clasp. Zippers cut from giant rolls cost less and require shorter ordering leadtime than the sized zippers used on more expensive pants

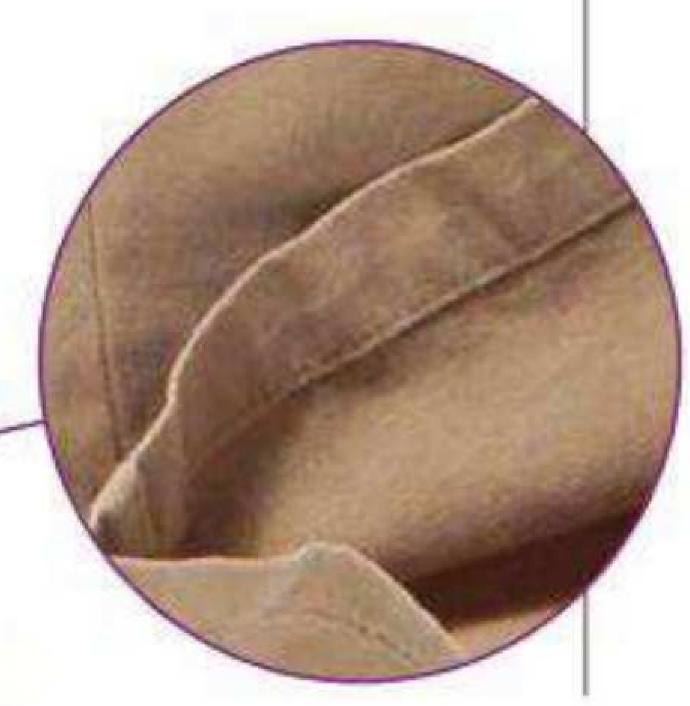


Side seams
Simply sewing front and back panels together saves time, but makes them bulky at the cuffs

$30
Small tweaks throughout the garment keep the cost of these cotton khakis low



The fly
A 2-piece fly would lay flatter—but it would take more material and time



Hem
This single-needle hem doesn't require the precision of costlier blind-stitch construction

Fabric
Since fabric accounts for up to half the cost of a pair of pants, makers can save by using cheaper cottons or rougher wools

From reducing the amount of lining to using fewer (and cheaper) plastic buttons, apparel makers have plenty of ways to save

WorldMags

Retailing

Despite Losses, Tesco's Still California Dreamin'

▶ The British retailer's U.S. food chain hasn't gained traction

▶ "I like quality, so I'll pay the extra buck or two" for a brand elsewhere

After conquering the U.K. grocery market, Britain's **Tesco** in 2007 set its sights on the U.S., opening a smattering of small outlets called Fresh & Easy on the West Coast. One recession and about £555 million ($894.9 million) in losses later, Tesco is modifying a strategy that confused shoppers and drew criticism from investor Warren Buffett, whose conglomerate **Berkshire Hathaway** owns about 3 percent of Tesco.

"They've had a real problem in California," Buffett said during Berkshire's annual investor weekend in early May. Berkshire Vice-Chairman Charlie Munger went even further: "Tesco is God Almighty in England," he told London's *Telegraph* recently. "But you come into Southern California, and you have **Trader Joe's** and **Costco**. That's tough competition. It's a different world."

Philip Clarke, who became Tesco's chief executive officer in March, is hoping to convince his fourth-largest investor that he can turn around Fresh & Easy. On top of the estimated $2.4 billion the company has already sunk into the unit, Clark is opening more U.S. stores. He's also launching Fresh & Easy's first TV ad campaign and testing in-store bakeries at some of the 175 outlets. Clarke has pledged to stop the losses by 2013—three years later than the company initially hoped.

The U.S. has been a tricky market for U.K. merchants. U.S. stores owned by **J Sainsbury** and **Marks & Spencer** both failed to catch on with American consumers. None of this stopped former Tesco CEO Terry Leahy from tackling the world's largest economy. It was the first time Tesco entered a market with a new format, creating small, neighborhood stores focused on selling fresh foods and ready-made meals.

Tesco didn't fully understand the preference for frozen food in the U.S. and is now adding more. It also doesn't accept manufacturers' coupons, a staple of U.S. retailing. For the last 18 months it's been adding coupons of its own for, say, $3 off a $30 bill, to its weekly flyer to attract shoppers. Some consumers were also confused by the predominance of the chain's own house brands rather than widely advertised national labels. "They were unlucky; they went out to the U.S. at a very bad time," says William Hobbs, who helps manage $264 billion in assets at Barclays Wealth. "But really they didn't get their offer right. It's a very difficult, competitive market."

9.4%

Increase in Fresh & Easy's same-store sales in 2010

Tesco has expanded Fresh & Easy's offerings to 5,000 products, from 3,500, says Simon Uwins, the chain's chief marketing officer. He added low-sodium and low-fat Eatwell prepared meals to compete with **Nestlé**'s Lean Cuisine dinners. Stores have been repainted to include brighter colors. "We're very confident that we've got Fresh & Easy in a place that customers like it. We've just got to get more customers into it," Uwins says.

There are signs of life: Same-store sales in the U.S. rose 9.4 percent in 2010, the fastest pace of any Tesco division. To keep it up, Uwins has to lure customers from rivals including **Aldi Group**'s Trader Joe's, which also specializes in selling its own products, and larger supermarkets such as **Wal-Mart Stores**, and **Safeway**, which offer a wider array of brands.

"Trader Joe's is very well-established. They too have very local customers who love their stores," says George Whalin at Retail Management Consultants, a retail and supplier advisory firm in California. Whalin thinks it may be easier for Fresh & Easy to lure customers from the big-box stores, hyping the time saved by shopping in its smaller outlets.





Some 30 percent of Fresh & Easy sales come from goods that originate at a huge campus in Riverside, Calif., where it produces freshly prepared meats and chilled prepared foods. Yet some customers remain cool to Tesco's reliance on private-label items. More than half of Fresh & Easy products are house brands, such as a 12-pack of Taurino beer for $7.99. "I like quality, [so] I'll pay the extra buck or two" for a brand, says Justin Pommer, 32, who lives across the street from a Fresh & Easy store in Hollywood but rarely shops there.

Such reactions from shoppers aren't encouraging. Explains Mike Dennis, an analyst at MF Global: "Realistically, even if we do get near break-even, [the U.S.] doesn't sum up as the second engine of growth for Tesco even after another few hundreds of millions." —*Sarah Shannon*

The bottom line *The world's second-largest retailer after Wal-Mart, Tesco has lost almost $900 million trying to expand in the Western U.S.*

Quoted

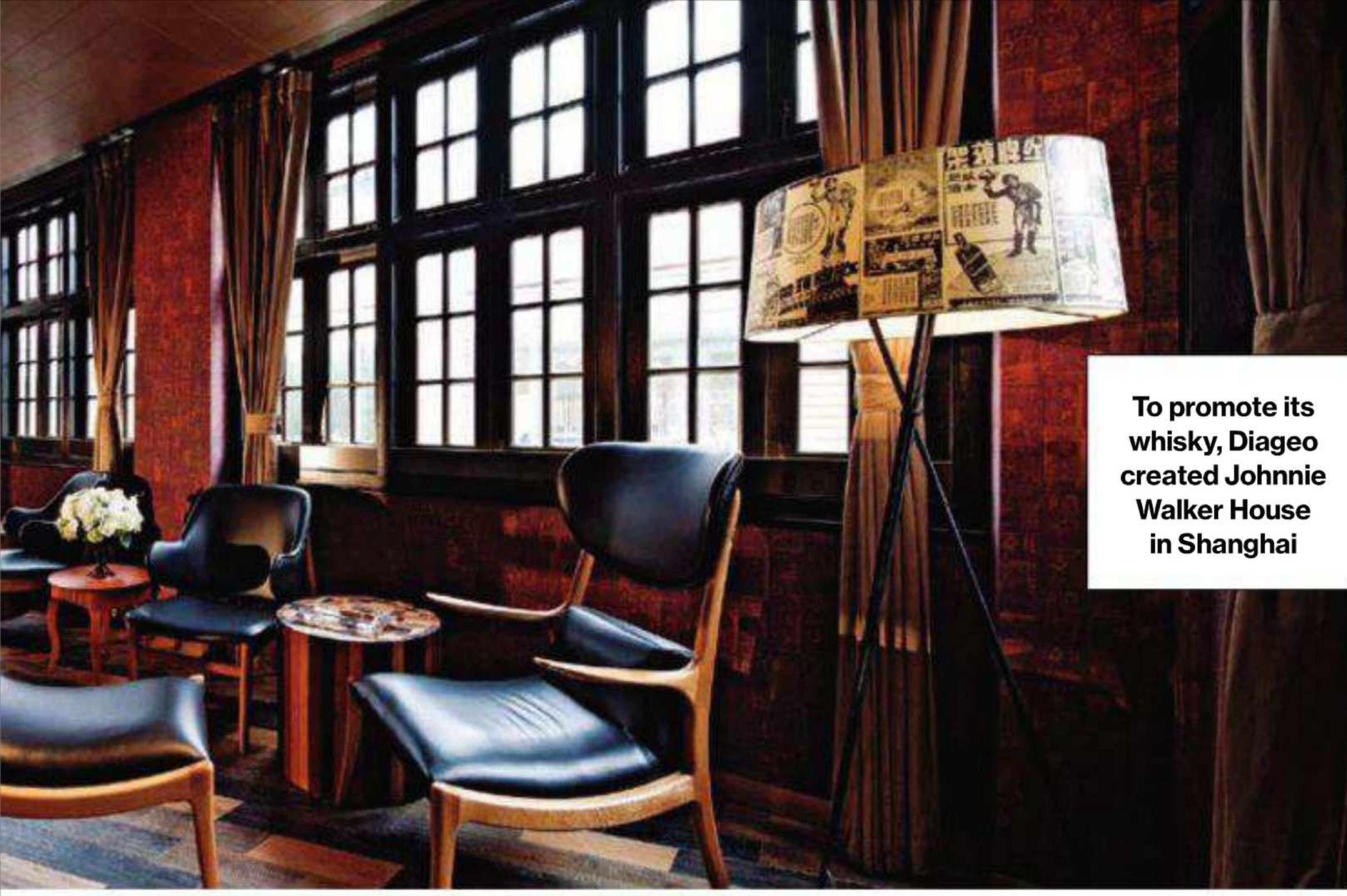
"The solution to high prices is high prices. It always forces companies like ours to figure out new ways to use less of these materials or use substitute materials."



—George Buckley, 3M Chief Executive Officer, on the positive side to the recent round of commodity price hikes that have pinched business margins.

BUCKLEY: GIUSEPPE ARESU/BLOOMBERG

WorldMags



To promote its whisky, Diageo created Johnnie Walker House in Shanghai



Spirits

How 'bout Some Scotch With Your Green Tea?

▶ Liquor giant Diageo hypes Johnnie Walker in cognac-smitten China

▶ It hopes younger Chinese "will start to behave like Western consumers"

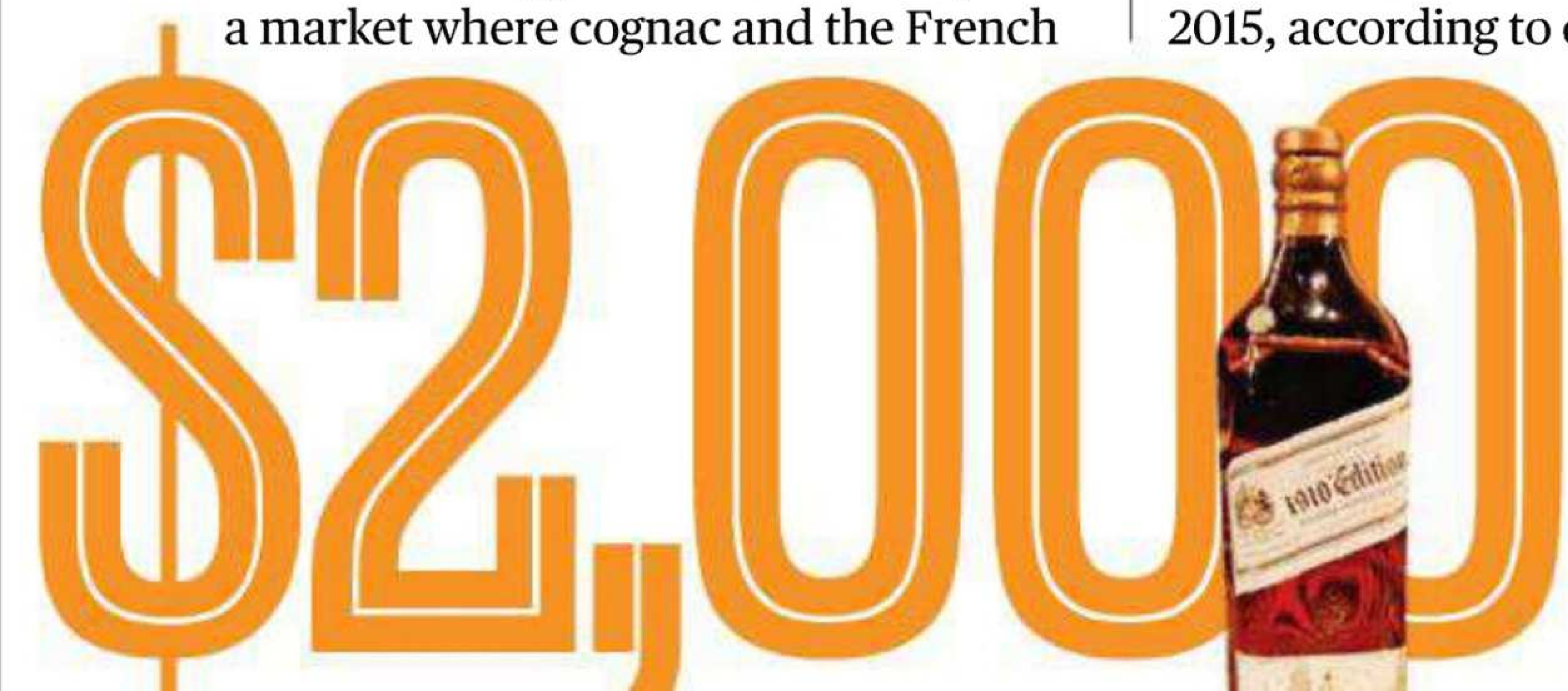
Diageo this month opened a tasting center in Shanghai's fashionable French Concession district to drum up new business in China for its Johnnie Walker brand of whisky. It's not your typical Scottish pub. Visitors to the Johnnie Walker House, a villa converted at a cost of almost £2 million ($3.2 million), are served on the first floor, where lights made from whisky bottles and walls made of peat and barley remind drinkers of the whisky's roots. Select customers—those who are influential or have deep pockets—gain invitations to the second and third floors for lessons about distilling, information about personalized bottle designs and bespoke packaging, and private tastings of pricey bottles like the $2,000 limited-release 1910 Edition whisky. This temple to all things Johnnie Walker is "just the first of many initiatives we have in the pipeline" to drive growth in China, explains Gilbert Ghostine, president of Diageo's Asia-Pacific unit.

The world's largest distiller wants to increase the appreciation of whisky in a market where cognac and the French brandy Armagnac account for 66 percent of the value of all imported spirits, according to the *International Wine and Spirits Research Magazine*. Whisky has a 29 percent share, says *IWSR*. "Cognac's been established as the luxury category for 70 or 80 years," says Trevor Stirling, an analyst at Sanford C. Bernstein in London. "What Diageo has to hope is that a younger generation of Chinese will start to behave like Western consumers and say, 'We want a drink for our generation.' But it's likely to be a slow burn."

Diageo owns a third of **LVMH Möet Hennessy Louis Vuitton**'s alcohol unit in China, giving it a slice of cognac profit from that venture's top-end Hennessy, the No. 1 brand in the country by volume. Still, the joint-venture agreement limits Diageo's share of earnings and its ability to expand further into cognac in the region on its own. So Diageo is turning to whisky to meet emerging Chinese demand for luxe liquor. "Brands like Johnnie Walker, which are premium, aspirational, leading national brands, can offer you the status and face in China," says Ghostine.

It's easier to get consumers started drinking whisky than cognac, which is mostly drunk neat, Ghostine says. In Asia, whisky is often diluted with a mixer, including chilled green tea in China, which may appeal to younger drinkers who often prefer lighter quaffs.

Mainland China is set to be the fastest-growing market for luxury goods in 2011 and the world's third-largest by 2015, according to consultancy Bain.



The price for a bottle of Johnnie Walker's 1910 Edition

The superpremium segment includes richly priced, highly profitable bottlings that are popular among China's status-conscious wealthy. The company says growth in demand for its so-called super-deluxe whisky in the Asia-Pacific region—including, at $3,000 a bottle, The John Walker—is more than double the 8 percent growth in superdeluxe spirits.

Diageo is counting on emerging markets including China, where the economy is set to expand more than three times faster than the U.S. and Europe this year, to provide the bump it needs to keep pace with rivals **Pernod-Ricard** and **Remy Cointreau.** Both are growing faster in part due to the popularity of their cognacs in Asia. Diageo also is trying to catch up to Pernod's best-selling whisky in China; Pernod's Chivas Regal has a 37.5 percent share of the whisky market by volume, while Diageo had 27 percent last year, says researcher Euromonitor International. The market for the drink will grow 14 percent by value during the 10 years through 2015, Euromonitor says. That still trails the 17 percent expected gain for cognac.
—*Clementine Fletcher*

The bottom line *Johnnie Walker volume climbed 9 percent in the first half of this fiscal year in China, where the luxury-goods market is growing fast.*

Media Law

News Corp. Plays Chicken with Plaintiffs

▶ Settlements in hacking cases are proffered to avoid messy trials

▶ "This will be all over by Christmas," says one lawyer

A **News Corp.** unit, **News Group Newspapers**, has been sued more than two dozen times by actors, athletes, and politicians after allegations that journalists at its *News of the World* tabloid newspaper illegally accessed mobile-phone voice-mail messages for story tips. Its legal strategy? Apologize, offer plaintiffs generous pretrial settlements that are risky to refuse in the British legal system, and hope the whole episode fades from public view.

On Apr. 8, **News International**, another unit of News Corp. and

WorldMags



Craig Fugate and FEMA's comeback
page 29 ▶

publisher of *News of the World*, issued a statement expressing "genuine regret" and said it would set up a "compensation scheme with a view to dealing with justifiable claims fairly and efficiently." The apology came after the arrest of two reporters and an ex-news editor at the paper. On May 13, *News of the World* agreed to a £100,000 ($161,000) settlement with actress Sienna Miller of *Alfie* and *G.I. Joe* fame. Her ex-fiancé, Jude Law, who starred in *Sherlock Holmes*, and her stepmother, Kelly Hoppen, tentatively plan to take their lawsuits to trial.

Lawyers following the case say these plaintiffs will have a strong incentive to settle if the media conglomerate makes a generous financial offer. Under British law, if a plaintiff or defendant turns down a pretrial settlement offer and then loses or wins a lower sum in court, he or she is liable for the other party's legal costs. Niri Shan, head of media at London law firm Taylor Wessing, says News Corp.'s legal bill could reach £400,000 in the Law and Hoppen cases.

By offering to settle with Miller and in other earlier cases on "overgenerous, irresistible" terms, News Corp. has effectively shut down the case, says Duncan Lamont, a media lawyer at Charles Russell in London. Even though trials have been scheduled for next year, "it will all be over by Christmas," he says. Mark Thomson, the lawyer who represents both Miller and Law, didn't respond to messages seeking comment. *News of the World* spokeswoman Hayley Barlow and News International spokesperson Daisy Dunlop declined to comment.

£60,000

Record payout for a privacy verdict in Britain

Miller's settlement offer was higher than the record £60,000 privacy verdict won by former **Formula 1** Chief Max Mosley following a *News of the World* story that claimed he took part in a Nazi-themed orgy. Thomson, the lawyer for Miller, said the case might be worth as much as £400,000 at a hearing in early May, prior to settling the case. News Corp. has set up a £20 million fund to compensate victims, according to a person familiar with the matter. A police investigation into the phone hacking continues.

—James Lumley and Erik Larson

The bottom line *A News Corp. tabloid has settled in a lawsuit tied to its phone-hacking scandal—and more payouts are expected.*

Commencement

CEO Wisdom, Class of 2011

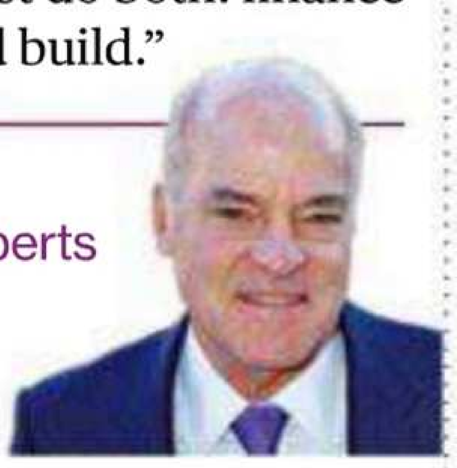
—by Cecile Vannucci

John C. Cushman III
Chairman, Cushman & Wakefield
Marshall School of Business, USC
May 13

"On behalf of everyone born before 1975, I want to express my sympathy for the hand you've been dealt. Who ran up global debt imbalances and the U.S. federal debt to the tune of 100 percent of [gross domestic product]? We did. Who has to pay it off with interest? You do."

Andrew N. Liveris
CEO, Dow Chemical
Broad College of Business, Michigan State University
May 7

"Today, most of our top business talent seeks to be in finance and capital markets. If that's the only role we play, providing capital to other nations, sooner or later they are going to cut out the middleman. Countries can and must do both: finance and build."



Henry Kravis
Co-CEO, Kohlberg Kravis Roberts
Columbia Business School
May 15

"Bad news and criticism deserve more attention than compliments. We live in a world of fierce competition, and arrogance will kill you."

Steven Ballmer
CEO, Microsoft
University of Southern California
May 13

"You get some success. You run into some walls. It's how tenacious you are, how irrepressible, how ultimately optimistic and tenacious you are about it that will determine your success."

Ellen Kullman
CEO, DuPont
Lehigh University
May 23

"Your career, if it is to be a successful one, will be a series of collaborations as a member of many different teams. And the secret to being a valued contributor to those teams will be your development as a lifelong learner."

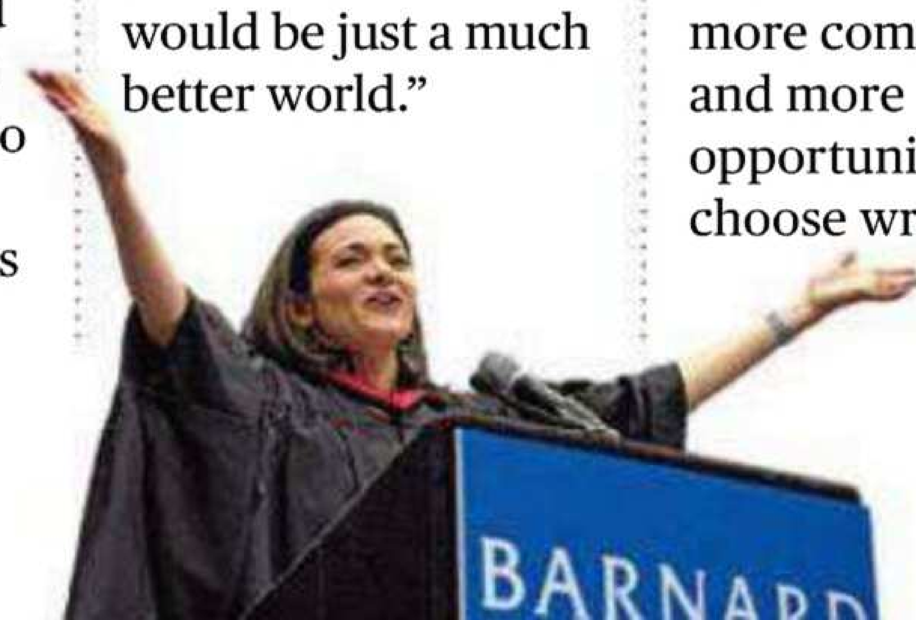


Biz Stone
Co-founder, Twitter
Babson College
May 14

"Opportunity can be manufactured. Yes, you can wait around for the right set of circumstances to fall into place and then leap into action, but you can also create those sets of circumstances on your own. In so doing, you manufacture your opportunities."

Sheryl Sandberg
COO, Facebook
Barnard College
May 17

"A world where men ran half our homes and women ran half our institutions would be just a much better world."



Vikram Pandit
CEO, Citigroup
Wharton School, University of Pennsylvania
May 15

"More ideas to choose from means more complexity—and more opportunities to choose wrongly."

James Rogers
CEO, Duke Energy
North Carolina State University
May 14

"The best graduation gift that I—or any of us—can give you is the copyright to your own story. Begin writing it today. Write it with passion and purpose. And write it without limits."

Rex W. Tillerson
CEO, ExxonMobil
Worcester Polytechnic Institute
May 14

"Like no generation before you, more of you—more likely all of you—will be required to consider the entire world clearly, and understand how your life and your abilities can help meet shared global challenges. We must now see the present and the future in a global context."

CLOCKWISE FROM TOP CENTER: CHARLES DHARAPAK/AP PHOTO; JAY MALLIN/BLOOMBERG; LOUIS LANZANO/BLOOMBERG; PETER FOLEY/BLOOMBERG

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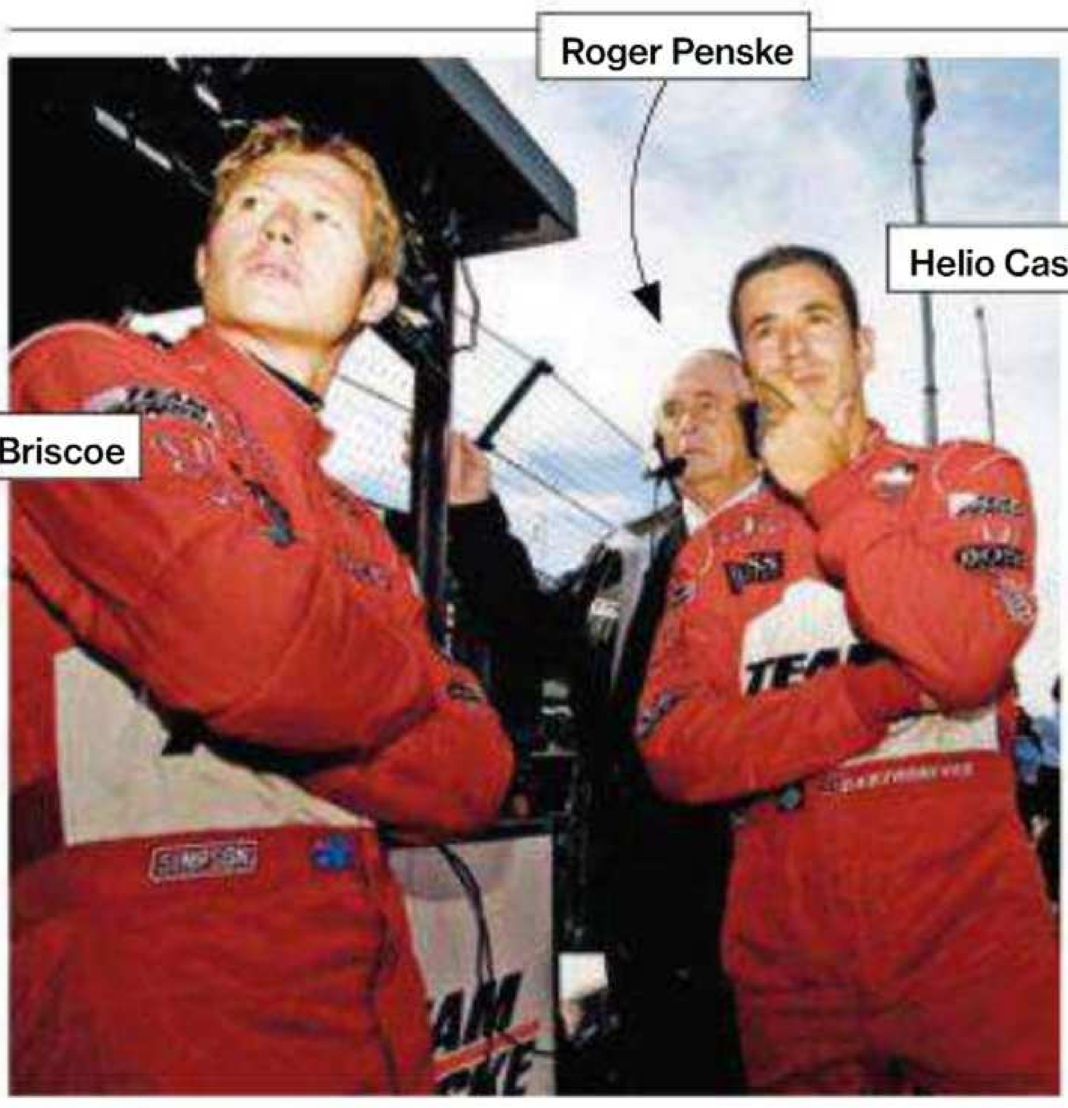
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Charlie Rose talks to Roger Penske & Team

“We couldn’t afford to buy the advertising on TV that we get when we’re ... leading the Indy 500”



Roger Penske has three drivers in the 100th running of the Indianapolis 500. He and his racers discussed speed, winning —and how close Penske came to buying Saturn from GM

Roger, your drivers have won a record 15 checkered flags at Indy—and Helio has a shot at tying the record for the most wins there if he gets his fourth. What is it about the Indy 500 for you?
Roger Penske: I think it’s the greatest race in the world. There is something about the history. I go back 60 years with it. When I attended with my dad, we didn’t have good seats. We could hardly see the cars go by, but it was in my blood and the race has helped me, from a business perspective, to build our brand. We couldn’t afford to buy the advertising on TV that we get when we’re racing and leading the Indy 500, so it’s been terrific.

And you’re there in the pits every time?
Roger Penske: Absolutely. I say it’s my fishing trip. It’s my golf game on Saturday or Sunday. I have been at every race, and I typically run one of the cars. We have a contest amongst two or three of our key guys. We’re racing each other. I’ll be with Ryan Briscoe this year. We have Tim Cindric, who has always worked with Helio, and Clive Howell will be on the radio with Will.

What’s the biggest change since you first started out? Is it the speeds?
Roger Penske: There’s no question. If you think about back in 1981, we had these stop watches, and when we went over 180 miles an hour they didn’t know how to calculate how fast we were going. [The gains in speed] came with the wings, the down-force we have on the cars. Today, Helio has a record lap of over 234 miles an hour. The speed through the corners has gotten so high it’s almost impossible to catch a vehicle if it gets sideways. The soft walls have helped from a safety standpoint. So we’ve seen increased safety, we’ve seen higher corner speeds, but the straight-away speeds are the same as they were back probably 50 years ago.

What makes a winner, the driver or the car?
Helio Castroneves: It’s a combination of everything. I always say 50 percent is the driver, 50 percent is the car. For me, especially in the oval, you’ve got to have a great car. Otherwise, there’s not much you can take out of it.

What does the driver add?
Ryan Briscoe: At the end of the day, when we’re in the race, you have to execute. You need to be mistake-free, and you need to tune the car during the race, give good feedback to your engineer and to Roger during the race so we can make setup changes at the pit stops. It’s the longest race we have on the calendar. A lot of rubber goes down, the conditions change, and you need to keep up with the conditions with the setup of your car. That’s where the driver input makes a difference, and obviously, concentration. It’s a grueling race. Very narrow groove, and no room for error.

What about the pit stops?
Will Power: A lot of races are won in the pit. It’s a team sport, and last year we all had problems in the pit—and that pretty much cost us a championship.

What problems?
Will Power: Little mistakes like leaving the fuel rig in [as the driver was returning to the track].

Does it add pressure for you, knowing you could tie the record?
Helio Castroneves: No, because I want to win as much as Roger wants to win and as much as these guys want to win. Certainly I’m in a very unique position, I’m honored to be in this position. And I dream about it because I think you should dream big. But I’ve got to work four times as hard to get the fourth win.


How many times have you thought about buying a car company?
Roger Penske: As you know, I tried to put together the purchase of Saturn as it was being sold or shut down by General Motors. And I got, I think, to third base, though I didn’t quite get our friends at Renault on board. That would have been terrific. The Saturn brand, we had millions of owners of that particular brand. ... When you think that Toyota spends $30 million a day in research and development—and you see some of the problems they have had—I think it’s very tough for a small entrepreneur to be able to take a car company and move it.

So Roger, will you sit back and smile on Sunday or do you say, “Helio’s won three. Let him go”?
Roger Penske: My comment will be, “Boys, have at it.” I hope that’s my biggest problem—that we’ve got all three of them coming down the straightaway. Ⓑ



Watch Charlie Rose on Bloomberg TV weeknights at 8 p.m. and 10 p.m.

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Voting begins 5/9/11 and runs for 100 days until 8/16/11. Voters must be legal residents of the 50 United States or D.C. in compliance with eligibility requirements and voting rules located at www.facebook.com/toyota. Limit one (1) vote per person, per voting day. ©2011 Toyota Motor Sales, U.S.A., Inc.

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State Budget Cuts, Reconsidered

▶ **Rebounding tax revenues may blunt the drive to cut spending**

▶ **"The party is over.... It's time for us to pay our bills"**

On May 11, when Wisconsin's State Budget Office announced that two-year tax revenue would be $636 million more than expected, school officials were heartened. They hoped the newfound money would be used to help restore an $834 million cut in school funding proposed by Governor Scott Walker. It wasn't to be. Within hours of the announcement, Walker said he wanted to use the money in other ways, including retiring the state's bond debt ahead of time. "Just like Wisconsin families," he said in a statement, "our first priority is to pay off past-due bills and debts."

A new chapter in the budget drama is playing out in statehouses across the country as the recovery begins to kick in. State revenue tumbled when the effects of the housing collapse rippled through the economy in late 2008. Governments reacted by increasing taxes and cutting services. In a handful of states, Republicans have called for reforms meant to shrink government and reduce the number of state employees. Now the rationale for those policies is beginning to weaken.

Evidence of a turnaround in state finances seemed to surface almost daily in May. California, Texas, Ohio, Connecticut, New Jersey, Michigan, and Colorado all reported higher-than-anticipated tax revenues, setting off a scramble to rejigger budget projections. In nearly every state in the nation, revenue is up, year over year, for the fifth straight quarter, according to reports by Goldman Sachs and the Nelson A. Rockefeller Institute of Government. The Rockefeller report, released on May 24, pegged the overall increase in the first quarter of 2011 at 9.1 percent, the largest gain since 2006.

Tax hikes played a role in the improvement. Illinois raised its personal income tax rate from 3 percent to 5 percent in January, for instance. Yet most of the new revenue came from an increase in personal and corporate tax collections as the economy rebounded. The biggest bump in state revenue, 15 percent, was in the industrial Midwest. Goldman Sachs's analysis suggests the growth was even stronger in April.

Not everyone is convinced that public finances are on the mend. In a May 18 interview, analyst Meredith Whitney of the Meredith Whitney Advisory Group predicted a "waterfall" of credit-rating downgrades on public debt. Some public policy experts are also cautious, arguing that the recovery in states' finances remains fragile. "It's important to keep in mind that they're in a very, very deep hole," says Phil Oliff, a policy analyst with the ➔



Percent change in first-quarter 2011 tax revenue from a year earlier

New England	**8.0**
Connecticut	11.1
Maine	11.4
Massachusetts	6.5
New Hampshire	(0.1)
Rhode Island	4.6
Vermont	12.3
Mid-Atlantic	**5.5**
Delaware	20.7
Maryland	4.2
New Jersey	5.9
New York	6.2
Pennsylvania	2.9
Great Lakes	**15.1**
Illinois	22.2
Indiana	10.3
Michigan	14.0
Ohio	11.6
Wisconsin	13.3
Plains	**9.7**
Iowa	7.6
Kansas	10.8
Minnesota	11.9
Missouri	2.4
Nebraska	8.1
North Dakota	39.4
South Dakota	7.0
Southeast	**10.1**
Alabama	3.1
Arkansas	3.1
Florida	6.3
Georgia	13.1
Kentucky	6.5
Louisiana	14.6
Mississippi	3.4
North Carolina	20.3
South Carolina	17.2
Tennessee	5.1
Virginia	13.1
West Virginia	17.2
Southwest	**8.7**
Arizona	9.6
New Mexico	N/A
Oklahoma	14.4
Texas	7.8
Rocky Mountain	**11.7**
Colorado	12.9
Idaho	11.2
Montana	6.6
Utah	11.9
Wyoming	11.4
Far West	**8.8**
Alaska	215.7
California	5.6
Hawaii	N/A
Nevada	N/A
Oregon	19.2
Washington	5.3

Despite the state's windfall, **New Jersey** Republican Governor Christie says he's standing firm on spending cuts

Illinois hiked the personal income tax rate by **67%**

Wisconsin is banking on an additional **$636** million in tax revenue through the end of its budget cycle

The run-up in crude oil prices is behind **Alaska's** eye-popping increase in state revenue

In **California**, Democratic Governor Jerry Brown has upped revenue projections by **$6.6** billion

DATA: NELSON A. ROCKEFELLER INSTITUTE OF GOVERNMENT; PHOTOS (FROM LEFT): KEN JAMES/BLOOMBERG; SCOTT OLSON/GETTY IMAGES; RAMIN TALAIE/BLOOMBERG

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Center on Budget and Policy Priorities in Washington. "They're just beginning to dig out."

State tax collections in the first quarter were still down $4.9 billion, or 3.1 percent, from the same quarter three years ago, according to Lucy Dadayan, an analyst at the Rockefeller Institute. In California, Governor Jerry Brown's May 16 announcement of a $6.6 billion upward revision to the state's revenue projections still left the state $10 billion short of its needs. Disappearing federal stimulus funding will also dampen state outlooks.

At least two states, Colorado and Michigan, have softened planned budget cuts. In California, the revenue bump is undermining Republican support for Brown's push to extend about $9 billion in taxes that are set to expire on June 30. Brown wants the issue on the ballot this fall. "States developed a really bad habit of living beyond their means when times were good and then relying on the federal government to bail them out," says Curtis Dubay, a senior policy analyst at the conservative Heritage Foundation.

Governors in Ohio, Wisconsin, and New Jersey want to use new revenue to retire debt or cut taxes instead of restoring funding to programs. "The party is over, and the adults have returned," New Jersey Governor Chris Christie, a first-term Republican, said on a May 19 radio show shortly after the state's legislative forecaster revealed that revenue through June 2012 would be $914 million higher than predicted. "It's time for us to pay our bills, cut the size of government, and cut taxes." Six days later the state Supreme Court rebuffed Christie's plans, ordering him to direct $500 million from next year's budget to the state's poorest school districts.

In Wisconsin, where Walker's battles with teachers and other public workers roiled the capital this winter, the governor's office said he intended to run the state conservatively, including paying down debt. School officials hope lawmakers overrule him. Walker "said these historic cuts were based on the fact that we were going broke," says Miles Turner, executive director of the Wisconsin Association of School District Administrators. "This should have been good news."
—Margaret Newkirk, with Michael Marois

The bottom line *A faster-than-expected recovery in tax revenue has some states loosening their belts, while others stick to austerity plans.*

Municipal Government

The Hamlet May Be An Endangered Species

▶ Tiny townships are under pressure to merge to save costs

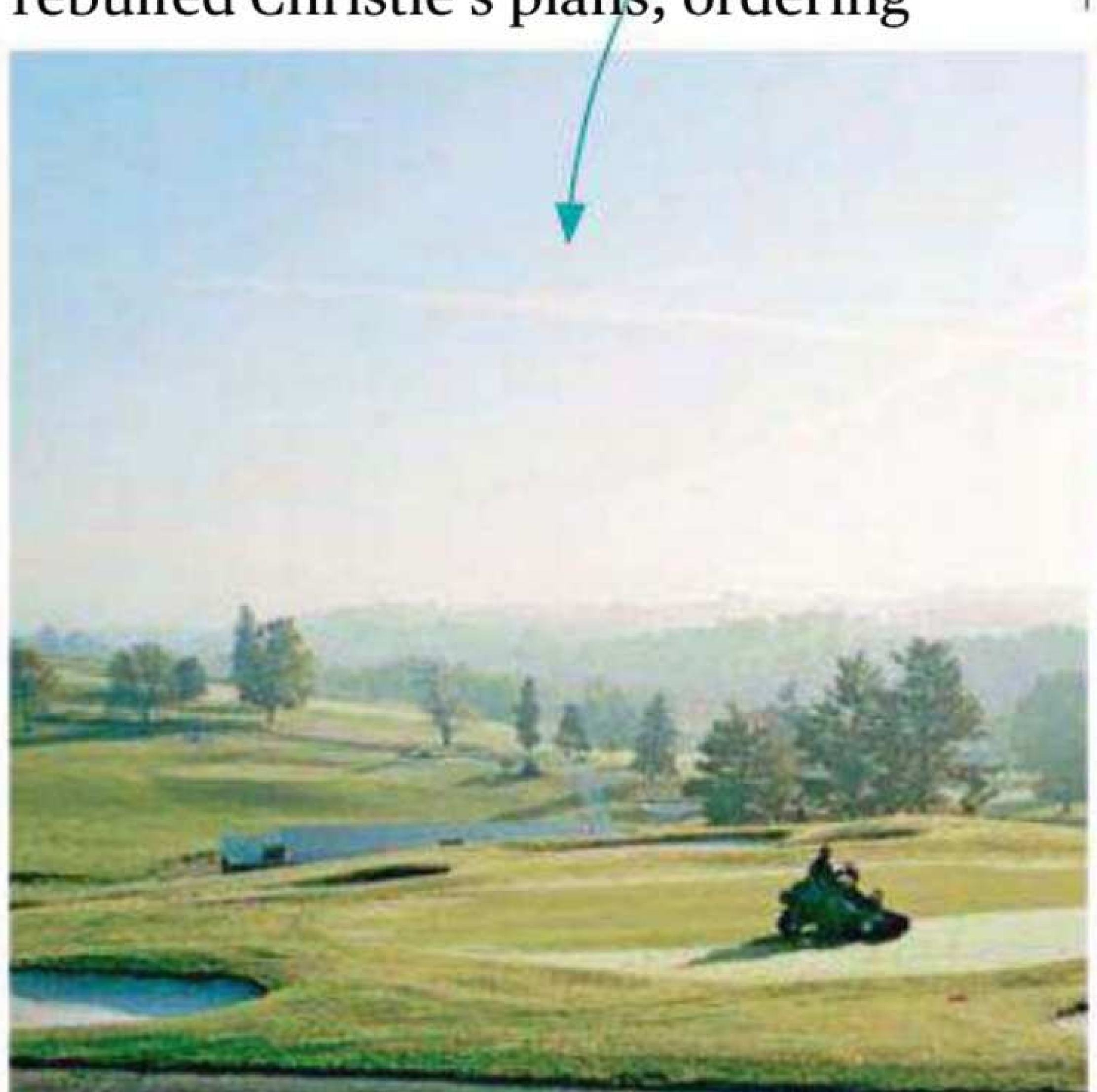
▶ "A lot of them know in their hearts it's the right thing to do"

There are no road signs in this area of western Pennsylvania betraying the presence of Green Hills, a square-mile borough with a population of 29. Green Hills was incorporated in 1978 for the sole purpose of securing a state liquor license for the Lone Pine Country Club—because the golf club was located in a "dry" township. Mayor Terry D. George draws no salary and presides over an annual budget of about $10,000. When asked what compelled him to seek office, the 63-year-old golf pro answers: "Someone has to do it."

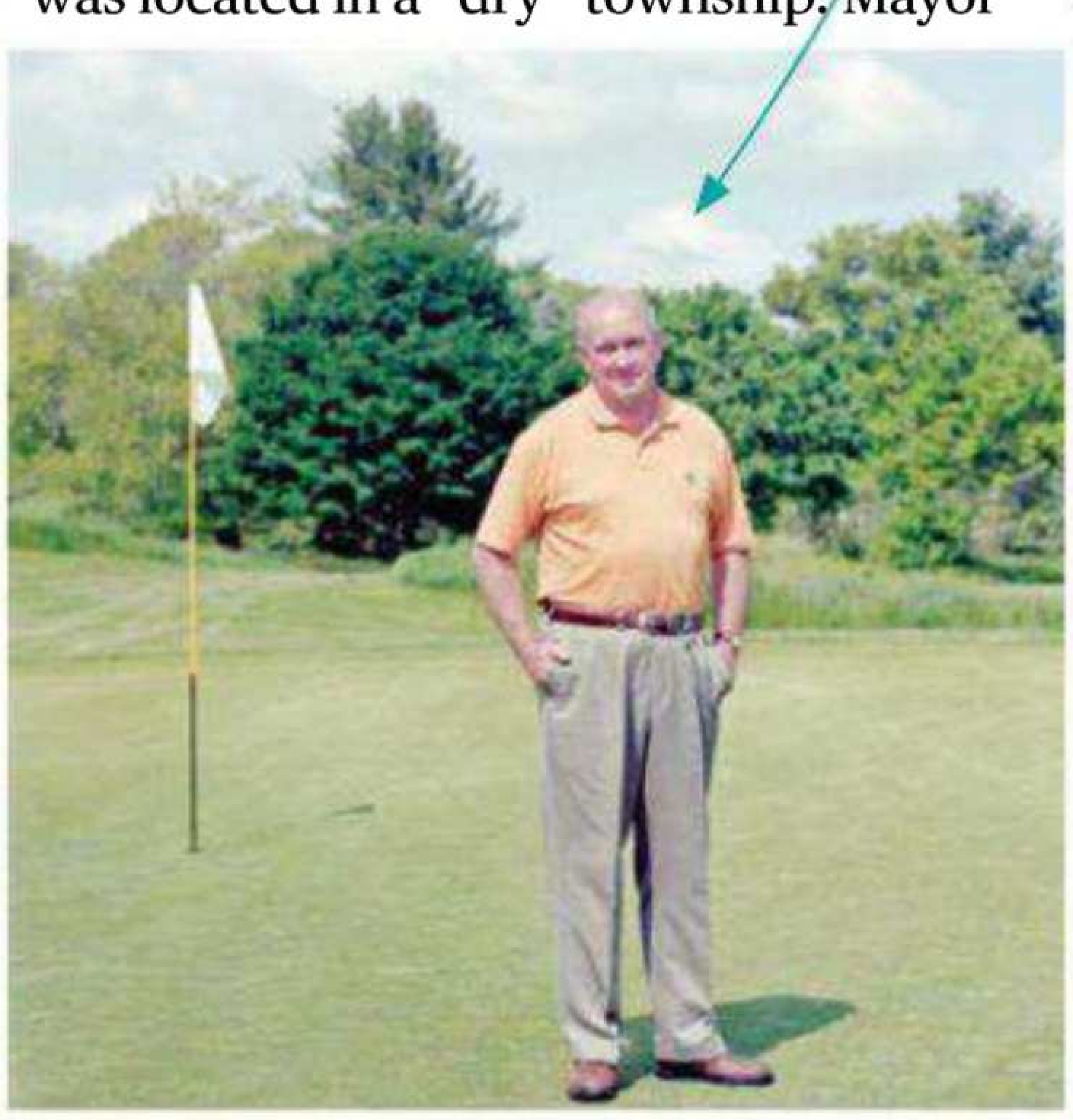
Politicians in several states say the existence of hamlets such as Green Hills can no longer be justified with budget shortfalls nationwide that could total $112 billion in the coming fiscal year. Pennsylvania, Ohio, New Jersey, and Michigan, among others, are pushing school districts and local governments to share more services and to consolidate for the sake of efficiency and cost. "People are saying, 'Come on, we know why you would want to keep it this way, but we just can't continue to afford it,'" says Scott D. Pattison, executive director of the National Association of State Budget Officers in Washington.

In Pennsylvania, Democratic State Representative Thomas R. Caltagirone introduced a bill last year that would require consolidation among the commonwealth's 2,652 boroughs. Approximately one-third of these self-governing townships have 1,000 or fewer residents, according to the Pennsylvania Community and Economic Development Dept. The legislation wasn't adopted, Caltagirone says, because getting residents and elected officials to surrender control isn't easy. "A lot of them know in their hearts it's the right thing to do, but politically they're afraid to touch it," says Caltagirone of his fellow lawmakers.

To overcome resistance, Ohio Governor John R. Kasich, a Republican, has floated the idea of a bipartisan panel, similar to the federal Base Closure and Realignment Commission, to analyze



Green Hills is home to a 175-acre golf course—and not much else



Mayor Terry D. George, a golf pro, draws no salary for his services



There are 29 residents, according to the last census

PHOTOGRAPHS BY ROSS MANTLE FOR BLOOMBERG BUSINESSWEEK

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consolidations and document the benefits. "If you can't show that there's something to be gained, you're not going to get it done," says Kasich. The Buckeye State has nearly 3,700 local government entities—including villages of as few as 27 people, according to the U.S. Census Bureau. That's a legacy of the 19th century, when the boundaries of counties and townships were established so someone could make a round-trip to the county seat by horse and buggy in one day.

Indiana Governor Mitch Daniels, also a Republican, has proposed eliminating the state's 1,008 township governments, calling them "venerable but obsolete" in his Jan. 11 State of the State address. Cutting their three-member elected boards alone would save about $2 million a year in salaries and other costs, according to the Indiana Office of Management and Budget. The state legislature has so far declined to go along.

Some small towns already share many functions, such as fire protection and water treatment, so the notion that consolidation will deliver significant savings is a myth, says Matthew DeTemple, director of the Ohio Township Assn. "Counting up the number of local governments is a canard, a red herring that doesn't tell you anything." Gene Krebs, a former Ohio representative and county commissioner who is now senior director of government affairs and policy for Greater Ohio Policy Center, a Columbus-based nonprofit, counters that the state is "wildly overgoverned." Says Krebs: "Whenever people say, 'Well, we share services,' I go, 'Yeah, you share services the way my diet works: It works really good until I see chocolate cake.'"

In New Jersey, Governor Chris Christie is using financial pressure to nudge governments together. He has said he hopes his 2 percent cap on annual property-tax increases will force some of the state's 566 municipalities to consider mergers by restricting their ability to boost revenues. A citizen commission is studying a consolidation of Princeton Borough, which had 13,381 residents, with surrounding Princeton Township, population 17,404. Voters rejected three previous efforts. The Princetons had combined budgets of $60.7 million last year and might save $3.3 million by joining forces, according to a report by the Center for Governmental Research, a Rochester (N.Y.) nonprofit that is a consultant on the project. That includes $2.1 million from combining their police departments.

Pennsylvania Governor Tom Corbett and New Jersey's Christie say they don't want to force mergers, preferring to leave the decision to local officials and residents. Jodie Main, a 30-year-old mother of two who with her husband moved to Green Hills in 2003 because she has relatives in the area, is not troubled by the idea that her town might one day cease to exist. "As far as fighting to keep a borough, that's not a large factor to me," she says. —*Mark Niquette, with Stacie Servetah and Terrence Dopp*

The bottom line *Several states facing budget shortfalls are offering incentives for townships to merge. Some residents are resistant.*

Disaster Management

Craigie, You're Doing A Heckuva Job

▶ Six years after Katrina, FEMA's reputation appears restored

▶ "They have been nothing but great"

A year after Hurricane Katrina leveled New Orleans and revealed the Federal Emergency Management Agency's ineptitude, state and local public officials in the region had so little faith in FEMA that they made their own arrangements to get ice, food, and generators for the next disaster. Now, as the sixth anniversary of Katrina approaches, communities coping with killer tornadoes and flooding this spring are surprised by an agency that has been revamped.

The FEMA team that arrived in Joplin, Mo., on May 22 after a tornado ripped through the city, killing at least 125 people, quickly coordinated with volunteers and helped with search-and-rescue efforts, says John Bartosh, presiding commissioner in Jasper County. "They have been nothing but great."

FEMA has deployed more than 1,000 employees in Alabama, where more than 50 tornadoes swept through the state's northern half on Apr. 27, leaving 238 dead and flattening thousands of homes and businesses. Its crew there and the Small Business Administration have already approved more than $54.7 million in disaster assistance for the state's residents, according to FEMA spokesman Mike Stone. "I've been very impressed with the dedicat-







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FEMA rushed to the scene of devastation after a tornado hit Joplin, Mo.

CHARLIE RIEDEL/AP PHOTO

ed professionals FEMA has put on the ground here in Tuscaloosa," says Tuscaloosa Mayor Walter Maddox. FEMA staffers are also on the ground in Oklahoma and Arkansas to help in the aftermath of tornadoes in those states.

Congress has taken notice of FEMA's improved performance. "We are better prepared for disasters of all kinds than we have ever been," said Joe Lieberman, the Connecticut independent who chairs the Senate Committee on Homeland Security and Governmental Affairs, in an e-mailed statement.

Lawmakers and emergency-management experts credit the turnaround to government reports that laid bare FEMA's flaws, a 2006 law that restructured the agency and, most recently, the arrival of FEMA Administrator W. Craig Fugate. Before the Senate confirmed him in 2009, Fugate had directed Florida's Emergency Management Div. since 2001. The 52-year-old Florida native got his start as a volunteer firefighter and paramedic in his hometown of Gainesville.

That accumulated experience stands in marked contrast to the background of Michael Brown, a former official at the International Arabian Horse Assn. who headed FEMA in Katrina's aftermath. "When you put a professional emergency manager" in the top FEMA spot, "it's a quantum level of performance than when you have a political" appointment, says James Carafano, a director at the conservative-leaning Heritage Foundation in Washington.

Fugate has what he describes as a "Waffle House" theory of emergency management to assess how bad a situation is after a disaster. "If the Waffle House is open and serving food and has got a full menu, then it's green," he said during an interview inside a FEMA mobile home parked outside a fire station in Joplin. "If the Waffle House is open but has a limited menu, it's yellow, and if the Waffle House isn't open, that's red." (Joplin's local Waffle House survived.)

Fugate has recruited former state directors at the agency, who deal directly with their regional counterparts, says Barry W. Scanlon, a former FEMA official who's president of Witt Associates, a Washington-based disaster-management consultant. Because of their past experience, the FEMA managers are sympathetic to the state officials and don't take a "top-down, 'this-is-the-way-it's-got-to-be' approach," he says.

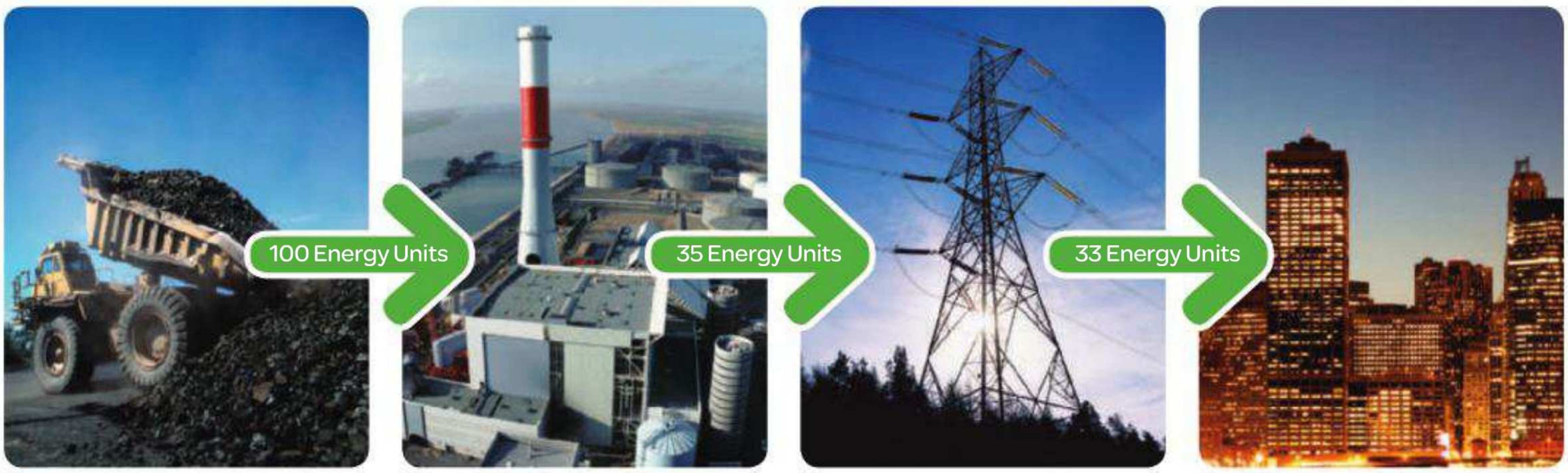
Prior to Katrina, as mandated by law, FEMA would wait to receive a governor's formal request for help before swinging into action. Under Fugate and his predecessor, David Paulison, FEMA staffers now show up ahead of any formal request for help. Fugate also works closely with local companies affected by disasters.

Much of the groundwork for the improvements was laid before Fugate got to the agency, according to disaster-management experts. The 2006 law rejiggered the agency's organization chart so that the administrator had more support. Fugate says there is more to do: There is too much focus on temporary shelters and not enough on building more permanent housing in disaster zones.

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*Source: World Energy Outlook 2009, IEA/OECD



Digital music heads to the cloud page 35 ▶

The next test is whether FEMA can buttress the long-term rebuilding efforts of storm-wracked communities. The question to ask, according to Scanlon, is, "What does Joplin look like a year from now?"
—Jeff Bliss and Mark Niquette, with Martin Braun

The bottom line *FEMA has rebuilt its credibility under W. Craig Fugate and responded to this spring's tornadoes by arriving before states request aid.*

Derivatives

Bachus is Wall Street's Man in Jefferson County

▶ The Alabama congressman backs GOP delay on derivatives reform

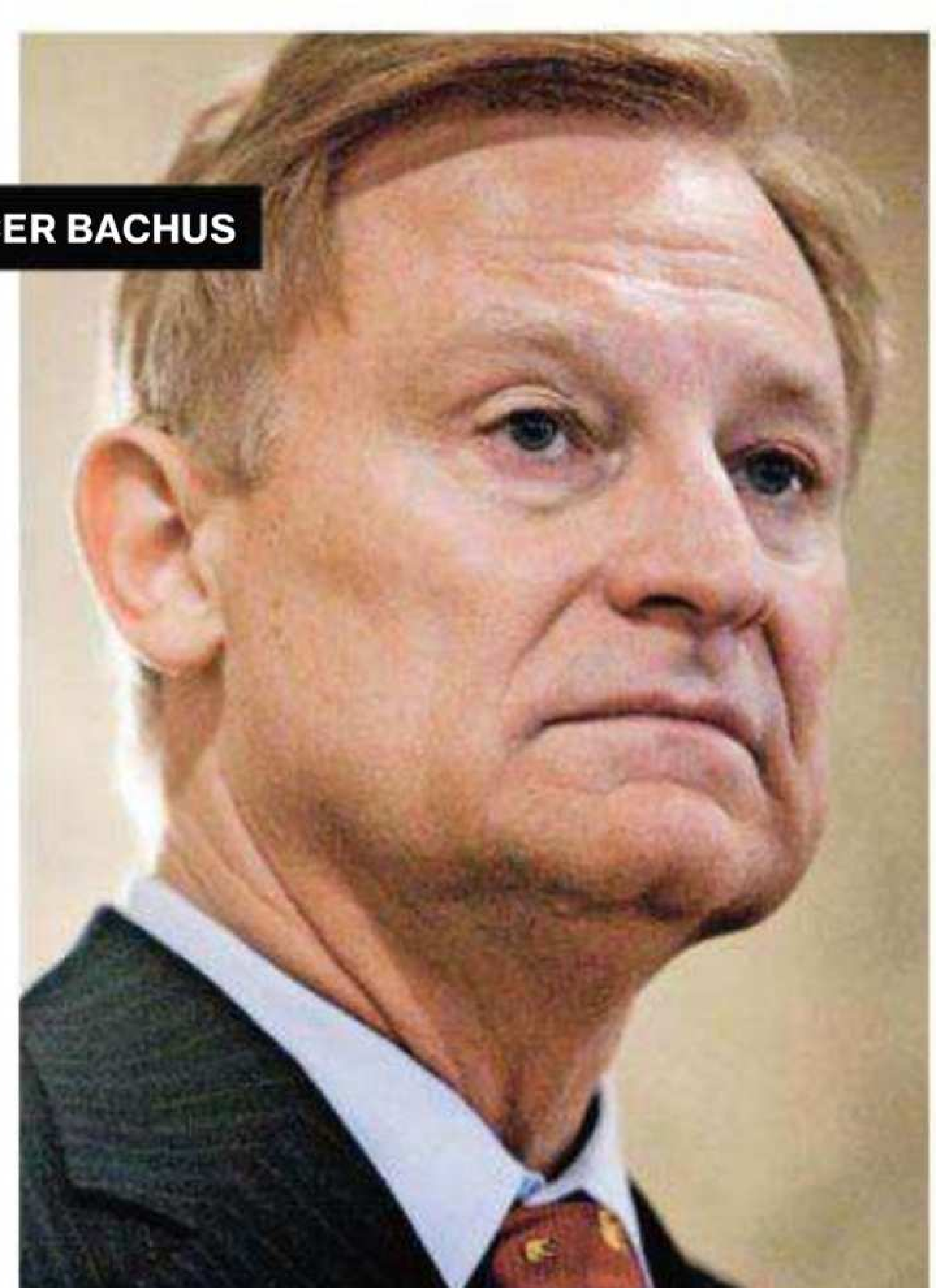
▶ "We're seeing the same deference in Congress to Wall Street"

In Homewood, Ala., retiree Lynn Arnold says the U.S. government should crack down on Wall Street after bond and derivative deals arranged by **JPMorgan Chase** left Jefferson County in a fiscal mess. "There needs to be something to help so this doesn't happen again to another county or another city," says the former audiologist, whose sewer bill may increase 25 percent to help pay for the debacle. "A lot of people are suffering."

Arnold's congressman is seeking to delay rules meant to do just that. During the past two decades, Spencer Bachus has been the U.S. House of Representatives' third-biggest recipient of donations from financial companies, totaling some $7.1 million, according to the Center for Responsive Politics. JPMorgan–and its employees–constitute the congressman's single biggest contributor. On May 24 the House Financial Services Committee, which the Republican leads, voted along party lines to stall regulations for derivatives, including those aimed at keeping the rest of the nation from repeating Jefferson County's mistakes, until September 2012. Bachus's regulatory delay faces long odds of becoming law while Democrats control the Senate and the White House.

Jefferson County officials have been considering bankruptcy since the deals, involving interest rate swaps, unraveled in 2008. Similar financing burned communities throughout the country, from Pennsylvania school districts to a California bridge operator, costing taxpayers more than $4 billion in bank fees to back out of the trades, according to data compiled by Bloomberg. "If anyone should understand why the investment banks need to be reined in, a member of Congress who represents Jefferson County should," says Barbara Roper of Pueblo, Colo., a lobbyist on financial issues for the Consumer Federation of America. "Unfortunately, we're still seeing the same deference in Congress to Wall Street that we did before they blew up the world economy."

Bachus, a soft-spoken 63-year-old, represents a Republican stronghold that includes affluent suburbs of Jefferson County, which encompasses Birmingham, the state's most populous city. When buttonholed by reporters at a May 2 conference in Washington hosted by a trade group that represents community banks, Bachus said that the misdeeds in Jefferson County had been fostered by corruption and had been punished by existing laws. He also said that he has raised no objections to tighter regulations for municipal derivative deals. In separate comments, he has denied Democrats' claims that his party is working to kill off the rules. "The people who wreaked havoc on our district were the people who took bribes and the people who bribed the contractors, they were people that did unnecessary swaps," says Bachus. "Jefferson County's problem is a debt problem and a criminal problem."



SPENCER BACHUS

JPMorgan led a team of banks that overcharged as much as $100 million on interest-rate swap deals after they persuaded Jefferson County to refinance nearly all its $3.2 billion of debt for a sewer project from fixed-rate bonds into floating-rate securities. When the subprime loan market collapsed, interest rates on those bonds soared. After provisions in the contracts forced the county to pay off the debt early, it defaulted. In 2009, JPMorgan agreed to cancel Jefferson County's swaps, forfeiting more than $647 million in fees. The bank gave the county $50 million and paid a $25 million penalty to settle an SEC investigation without admitting or denying the allegations.

$7.1m

Donations Bachus has received from financial firms over his career

The SEC said the bank overcharged the county on the transactions so it could funnel illicit payments to friends of county commissioners. Larry P. Langford, a former commissioner, was convicted of accepting bribes for arranging the financing and is serving a 15-year sentence. Two of his associates pleaded guilty, and two JPMorgan bankers are fighting civil charges from the SEC.

Bachus is a leading critic of the Dodd-Frank law, enacted in July, which would regulate derivatives as part of its rewriting of market rules. "I see Dodd-Frank takes us in the opposite direction of what made us great," Bachus told bankers at the conference in May. "It will redefine the way our economy operates for decades, it'll constrict jobs, and I think it'll punish Main Street businesses."

Roper, the Consumer Federation lobbyist, expects Wall Street to reward its allies in Congress in the coming months. "They will certainly be well funded for their next election," she says.
—William Selway and Martin Z. Braun

The bottom line *Representative Bachus backs a GOP push to delay reforms on the same derivatives that drove his county to the brink of bankruptcy.*

FROM TOP: QUICKHONEY; BRENDAN HOFFMAN/BLOOMBERG; OPPOSITE PAGE: ALAMY (8); GETTY IMAGES (2)

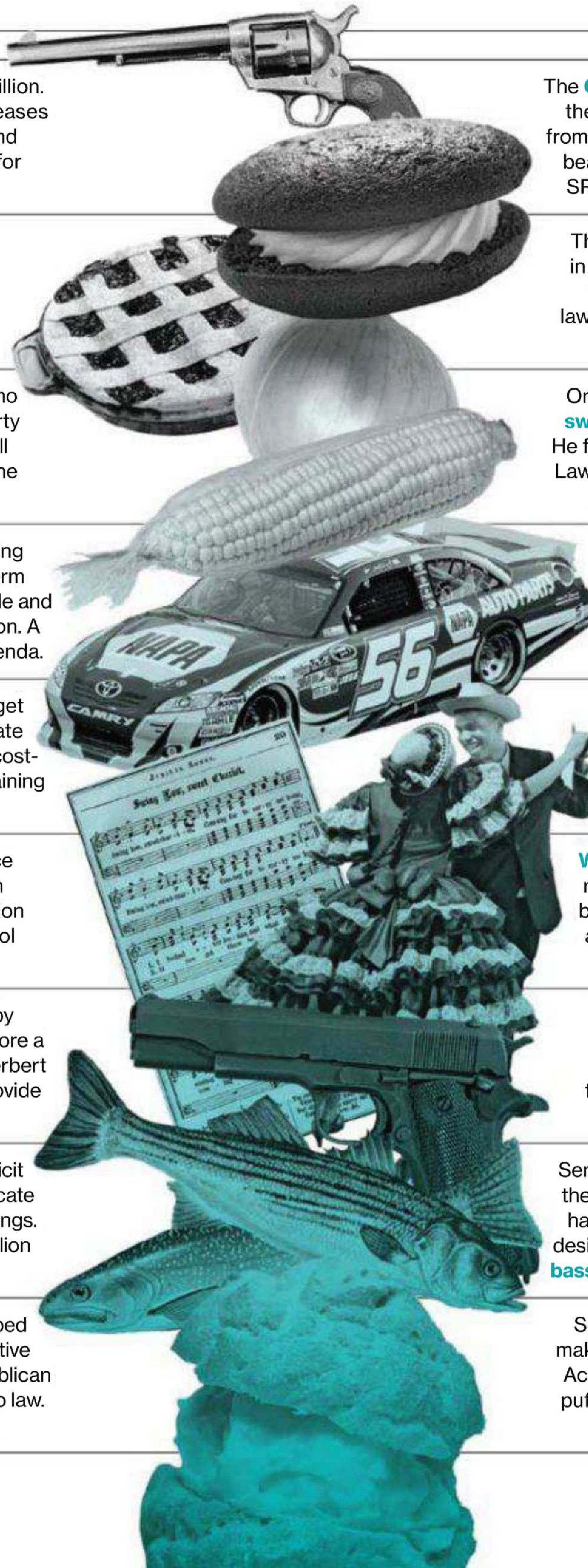
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Attention Deficits

Let's Make It Official

Ever since the red clover became Vermont's state flower in 1894, U.S. states have been conferring official status on everything from winged mammals to sugary confections. The practice may be harmless enough, yet the question arises: As states grapple with budget deficits of up to $112 billion in the coming fiscal year, couldn't lawmakers find more important things to debate? —*Esmé E. Deprez*



STATE PRIORITIES	OFFICIAL DISTRACTIONS
Arizona The deficit is approaching $1 billion. Lawmakers agreed to tie spending increases to population growth and inflation, and boosted the state's ability to borrow for school construction.	The **Colt single-action army revolver** became the state's official firearm in April. The gun from Connecticut-based Colt's Manufacturing beat out the Taser stun gun and the Ruger SR9, both made by companies in Arizona.
Maine The legislature is debating tax cuts and pension reform. It approved an overhaul of health insurance laws and banned texting while driving.	The **whoopie pie** became the state treat in April. The original legislation said state "dessert," but it was changed so that lawmakers could give wild Maine blueberry pie that honor.
New York Governor Andrew M. Cuomo wants lawmakers to approve a property tax cap, tighter ethics rules, and a bill allowing same-sex marriage before the legislative session ends in June.	One senator has spent five years pushing **sweet corn** as the official state vegetable. He faces competition from fans of the **onion**. Lawmakers are also considering making the rescue dog the official state canine.
North Carolina Legislators are weighing measures that would reinstate long-term unemployment benefits for 38,000 people and ban gay marriage in the state constitution. A curb on school snacks is also on the agenda.	The Senate voted in April to make **stock car racing** the official state sport. It also voted to declare gold the official state mineral in May.
Oklahoma Facing a $500 million budget shortfall, lawmakers eliminated the state pension system's automatic 2 percent cost-of-living adjustment and collective bargaining rights for some city workers.	A bill designating ***Swing Low, Sweet Chariot*** the state's official gospel song was signed by the governor and will become law in November.
Texas In the legislature, a conference committee agreed in late May to an $80.6 billion budget that cuts $15 billion in spending. About $4 billion in school spending was chopped.	**Western swing** was declared the state music in May. The Mexican free-tailed bat is the state's official flying mammal, and the Dutch oven the state's official cooking implement.
Utah Lawmakers overturned a veto by Governor Gary R. Herbert in May to restore a five-day workweek for state workers. Herbert said that the legislature had failed to provide the necessary $790,000 funding.	The governor signed a bill in March making the **Browning model M1911 automatic pistol** the official state firearm. The ever-popular Dutch oven is the state's official cooking pot.
Virginia After closing a $4.5 billion deficit last year, lawmakers reconvened to allocate $1.2 billion in additional revenue and savings. Higher ed got $98 million, and $508 million went to health and human services.	Senator John Miller sponsored a bill making the **brook trout** the state freshwater fish. It had previously been the state fish, but the designation was changed so that the **striped bass** could be named the state saltwater fish.
Wisconsin Senate Democrats decamped to Illinois to protest a bill curbing collective bargaining for most public workers. Republican Governor Scott Walker later signed it into law. A budget has not yet been passed.	Senator Mary Lazich introduced a bill to make **cream puffs** the official state dessert. According to a fourth-grade class pushing puffs, some 300,000 are sold at the 11-day state fair. That's 52 a minute.

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Technology

Digital Music May Get Convenient Real Soon

▶ **Apple's plan for "digital lockers" wins over the music industry**

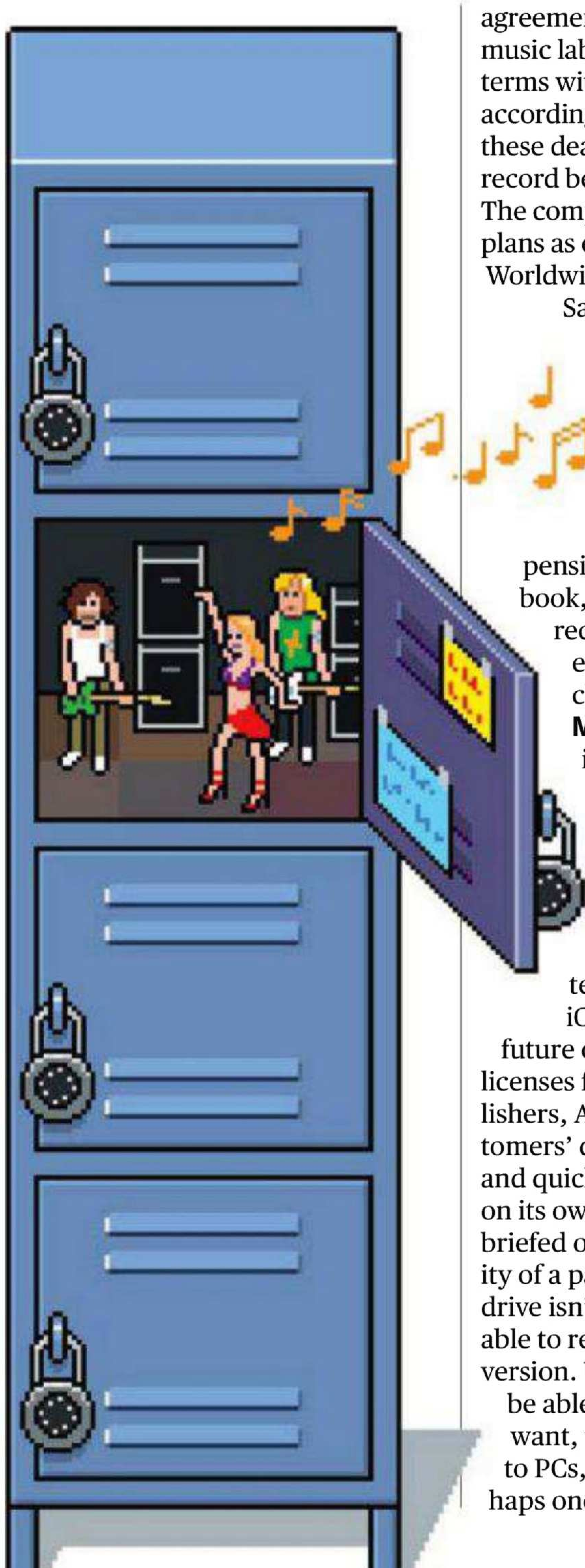
▶ **The labels "are about to give Apple even more power to dictate how music is consumed"**

Compared with buying e-books, building a digital music collection is a hassle. E-books zip directly to reading devices like the Kindle and Nook and are backed up "in the cloud"—on the servers of **Amazon.com** and **Barnes & Noble**. A digital song, on the other hand, is typically downloaded to a PC and must then be manually transferred to an iPod or mobile phone. If you lose your Kindle, you can always download an e-book again; if the PC crashes or the iPod falls into the bathtub, the song goes down with it.

Moving music to the cloud has been an elusive goal for big tech companies and their music industry counterparts, until now. In the past two months, Amazon and **Google** have unveiled cloud music services, albeit to mixed reviews and indifference from consumers. These new services let users upload their music collections into so-called digital lockers on the Internet and stream the songs they own to a variety of devices. Both are limited, because neither Google nor Amazon could reach an accommodation with music labels. Label executives say they are negotiating aggressively to make sure they profit from the shift to the cloud. It may be the last opportunity to stem rampant piracy and years of plummeting sales.

Apple, the reigning heavyweight of the music business, may have solved this cloud conundrum. It has reached agreements with three of the four major music labels and is close to reaching terms with the fourth, **Universal Music**, according to people with knowledge of these deals but who can't speak on the record because the talks are private. The company could preview its cloud plans as early as June at Apple's annual Worldwide Developers Conference in San Francisco. The music industry will be watching to see whether Steve Jobs & Co. have discovered a way to quell the deep anxieties of the music biz while creating a flexible, easy-to-use service that isn't too expensive. "With a big enough checkbook, anyone can get a deal with the record labels," says Michael Robertson, founder of an unlicensed cloud music locker called **Mp3tunes**, which is embroiled in a lawsuit with **EMI**. "The question is whether Apple's cloud music service will be consumer-friendly." Apple declined to comment.

The 99¢ download soon will look "as anachronistic as cassette tapes or 8-tracks"



ILLUSTRATIONS BY QUICKHONEY

Apple's music service, which Engadget and other tech blogs are already calling iCloud, might well represent the future of recorded music. Armed with licenses from the music labels and publishers, Apple will be able to scan customers' digital music libraries in iTunes and quickly mirror their collections on its own servers, say three people briefed on the talks. If the sound quality of a particular song on a user's hard drive isn't good enough, Apple will be able to replace it with a higher-quality version. Users of the service will then be able to stream, whenever they want, their songs and albums directly to PCs, iPhones, iPads, and perhaps one day even cars. And the

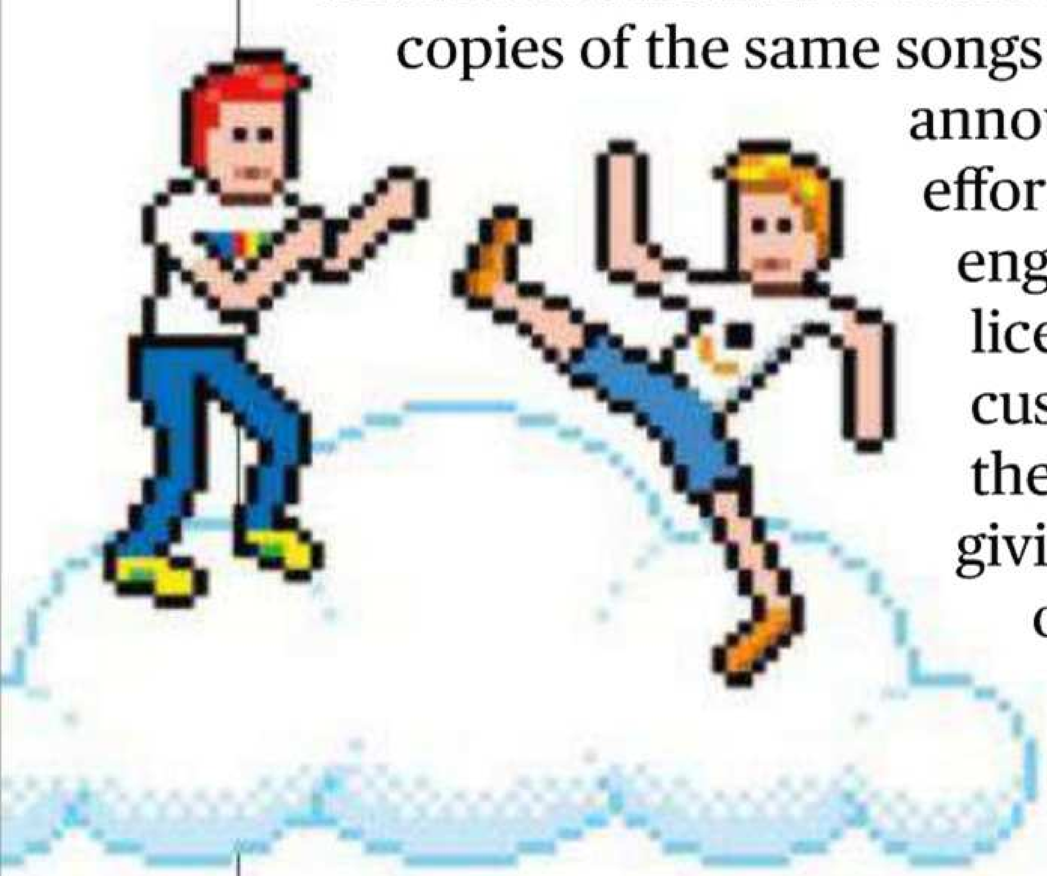
Technology



music industry gets a chance at the next best thing after selling shrink-wrapped CDs: monthly subscription fees, à la **Netflix** and the cable companies. "We will come to a point in the not-so-distant future when we'll look back on the 99¢ download as anachronistic as cassette tapes or 8-tracks," says Ross Crupnick, a music analyst at NPD Group.

While it may be a huge shift, it won't be free. Apple no doubt has paid dearly for any cloud music licenses, and it's unclear how much of those costs it will eat or pass on to consumers. One possibility would be to bundle an iCloud digital locker into Apple's MobileMe online service, which currently costs $99 a year and synchronizes contacts, e-mail, Web bookmarks, and other user data across multiple devices. Users will be able to store their entire music collections in the cloud—even if they obtained some songs illegally. That would finally give the labels a way to claw out some money on pirated music.

The service will probably vault Apple ahead of its major rivals in the race to the cloud. In March, Amazon unveiled Cloud Drive, which requires users to upload their entire collections onto the company's servers. That's a time-consuming process for customers and forces Amazon to store multiple copies of the same songs. Amazon announced the effort without engaging in licensing discussions with the labels and giving them only an 11th-hour preview, according to three people familiar with the matter. Labels objected to some elements, such as Amazon selling songs from its MP3 store and automatically storing backup copies of those files on its own servers without paying the labels any extra fees, according to executives at the labels. Amazon spokesperson Sally Fouts would not comment on the company's dealings with labels and says only that music sales have risen since the service launched. (On May 23 the company's servers overloaded when it offered Lady Gaga's new album, *Born This Way*, for 99¢.)



Google negotiated with the music labels for more than a year to create a cloud music service, then launched an unlicensed service similar to Amazon's when talks foundered. According to two music executives familiar with the discussions, Google was prepared to pay more than $100 million up front to the four major music labels for licenses, but talks broke down over the music industry's concern that search results in Google and YouTube often point to pirated music. Google's unlicensed service, Music Beta, allows users to upload 20,000 songs they already own for free and features an "Instant Mix" feature that can generate a playlist of similar songs based on a single track. But Google, unlike Amazon and Apple, still hasn't arrived at a basic deal with the labels to sell digital music. "We've been in active negotiations with the labels with mixed results," says Zahava Levine, director of content partnerships for Android, Google's mobile platform. "We want to help them sell their artists' music and have a lot to offer given the broad reach of Android and Google generally."

There's irony in the possibility of Apple trumping its rivals yet again in music. For years the labels have complained about Apple's hammerlock on digital music and sought to nurture a strong competitor. Now they "are about to give Apple even more power to dictate how music is consumed," says Daren Tsui, chief executive officer of mobile entertainment company mSpot. Yet Tsui and others believe that ultimately the cloud may deliver a more even playing field. Apple is unlikely to make its music service available for devices that run competing software, like Google's Android. And the labels figure that once Apple gets out the door, Google, Amazon, and others will follow with similar licensed services. Then the elegance of crashproof, bathwater-resistant, play-it-everywhere music will finally be within reach. —*Brad Stone and Andy Fixmer*

The bottom line *Apple may unveil a cloud-based music service in June. The music labels, which need a new revenue stream, are signing on.*

Mobile

Can Wi-Fi Work Citywide in New York?

▶ Towerstream plans to unveil a super-high-speed network in June

▶ "Until they get a carrier deal, this business is still very theoretical"

Imagine if smartphones always worked as fast as home Wi-Fi networks, and no one had to pray that a cellular signal was strong enough to send an e-mail or retrieve a map. A company called **Towerstream** hopes to make that dream come true for New Yorkers in late June, when it turns on a network of about 1,000 wireless routers—souped-up, weatherproof versions of the Wi-Fi devices in millions of homes. The goal, says Towerstream Chief Executive Officer Jeff Thompson, is to provide a superfast mobile network that covers seven square miles of Manhattan, and sell access to the system to wireless carriers that can use it to fill in areas prone to spotty service. (Lots of those in New York.)

In theory—the company hasn't announced any deals with carriers—consumers may never know they're using Towerstream's network. Behind the scenes, Carrier X would seamlessly switch a customer's smartphone or tablet to Wi-Fi mode when that person comes within range of one of Towerstream's hotspots, and the connection speed would go up dramatically. During a demonstration recently on the corner of West Broadway and Broome Street in New York's SoHo district, an iPhone's

Quoted

"It's not a brave new world; it's a bad new world."
—Sony Chairman and CEO Howard Stringer, on his company's hacker problems, in the *Wall Street Journal*



FROM TOP: SIMON DAWSON/BLOOMBERG; ANDREW HARRER/BLOOMBERG

There's life after BP for Tony Hayward page 43 ▶



data speed leapt from .35 megabits per second to 26 Mbps. That's fast enough to stream high-def video, and much faster than most home connections in the U.S.

Towerstream, a 12-year-old company that has specialized in providing broadband service to corporations, isn't the first to try large-scale Wi-Fi. In 2006 cities such as Philadelphia and Chicago announced networks; **Google** had plans to unwire its hometown of San Francisco. For a variety of reasons—slow speeds, high costs—those projects went nowhere. They were meant to cater to laptop users who wanted to connect wherever they were. Users weren't so desperate to do that, it turns out. Now users of mobile devices are.

While most of the failed experiments of yore were based on taxpayer-funded municipal projects, this time there's a clear business need for wireless carriers. Traffic that's processed via Wi-Fi doesn't take up any capacity on local cell towers and doesn't take up room on so-called backhaul connections—often decades-old copper cables—that bring traffic from the tower to the Internet. In Towerstream's network, data from iPads, Android phones, and such would be siphoned off by the nearest Wi-Fi antenna. Then the data would get passed along to other antennas until it reached one of nine large base stations around the city, including one at the top of the Empire State Building, and then travel right onto the Internet. "**AT&T**, **China Telecom**, and many others are doing this kind of 'Wi-Fi offload' " on a smaller scale, says Michael Howard, co-founder of market research firm Infonetics Research.

The antennas themselves are much cheaper and less obtrusive than cell towers. They're about the size of a football, cost about $800 apiece, and sit on poles or rooftops; cell towers can run upwards of $200,000. Towerstream representatives have fanned out in Manhattan, persuading landlords and building owners to let the company install the devices on their property. The company pays $50 to $1,000 per installation per month, depending on location.

There's little doubt about consumer demand. Last year, Towerstream conducted a three-month test of a 200-device Wi-Fi network in Manhattan. Without any promotion, the network handled 20 million Web sessions by consumers who happened to spot Towerstream when trolling for a Wi-Fi connection. That's a fifth of the Wi-Fi traffic generated by AT&T during the same three months at its hotspots, which include most **Starbucks** and **McDonald's**. Demand is expected to increase, even as cellular networks go from today's 3G technology to 4G. While 4G is roughly four times faster than 3G, overall data traffic is projected to rise more than

26
Mbps

Data speed in a Towerstream demo; enough to stream HD video

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30 percent per year, according to multiple studies. "If any of these estimates are even close to true, those 4G networks will be filled up almost immediately," says CEO Thompson.

Towerstream's stock has risen from $3.71 in early April to $5.21 because of its Wi-Fi ambitions, says Morgan Joseph TriArtisan Group analyst Ilya Grozovsky. "Jeff is obviously very excited about this opportunity," says Grozovsky. "But until they get a carrier deal, this business is still very theoretical." If carriers choose to build their own Wi-Fi rather than rent from Towerstream, Thompson may need to take the riskier step of selling directly to consumers. Should his Manhattan project take off, Thompson says he'll proceed to San Francisco, then Chicago, then to seven other cities. As Thompson says: "If you can make it here, you can make it anywhere."
—*Peter Burrows*

***The bottom line** City-spanning Wi-Fi has been tried before. Towerstream's effort may work because of the rise of smartphones and tablets.*

Electronics

A Post-Fukushima Rebound for Toshiba

▶ Demand increases for memory chips and iPad screens

▶ Margins are a problem: "They need to buckle down and cut costs"

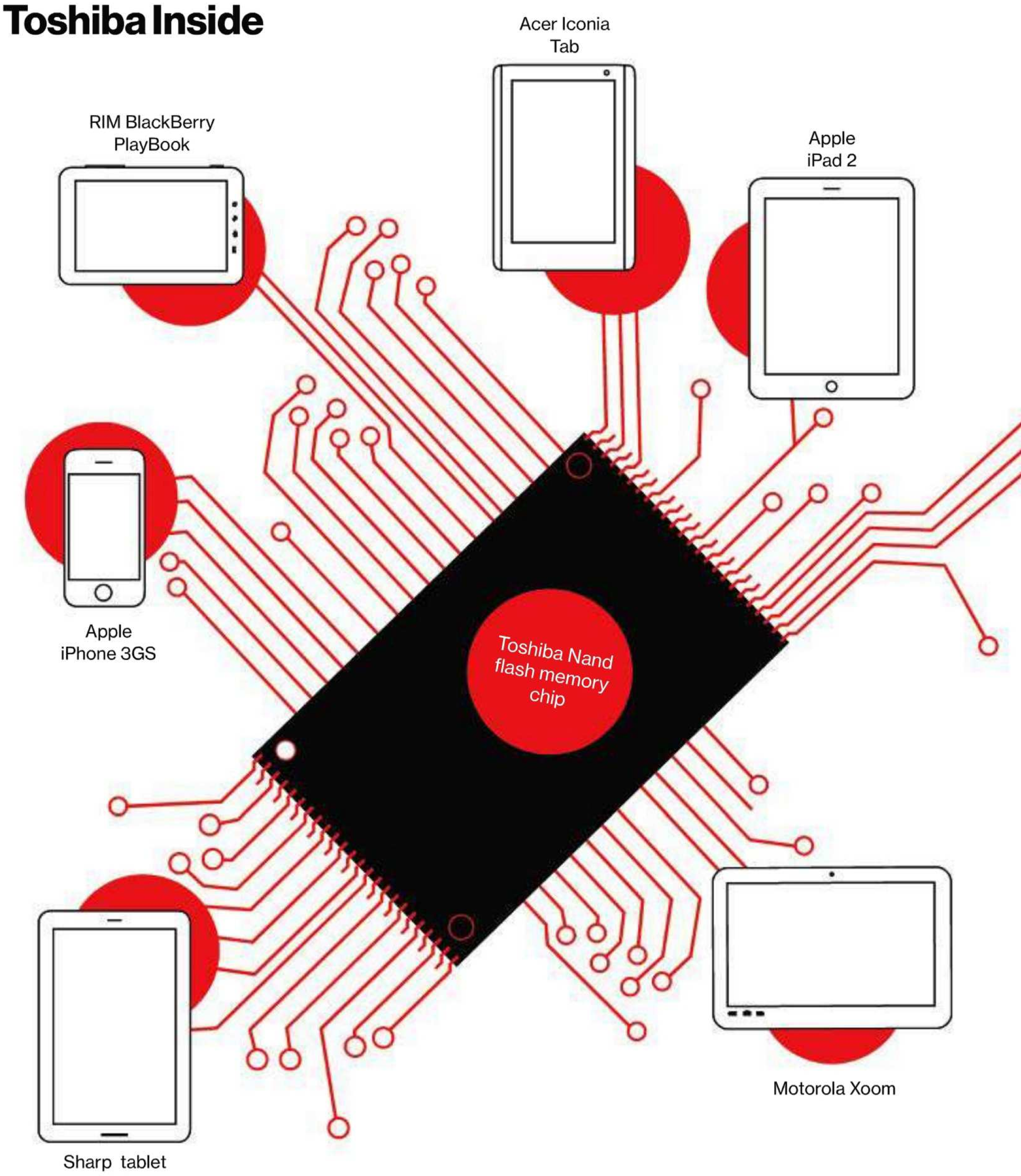
After the Mar. 11 earthquake and tsunami, few Japanese companies were in worse shape than **Toshiba**. The Tokyo-based maker of semiconductors, computers, and televisions is also one of the world's leading makers of nuclear power plants, and with the Fukushima crisis putting that industry in peril worldwide, investors dumped the stock. Toshiba's share price plunged 27 percent in the week following the disaster, making its shares the second-worst-performing on the Nikkei index. Only **Tokyo Electric Power**, the operator of the Fukushima nuclear power plant, did worse.

Since then, Toshiba's stock has shown surprising resilience, a recognition of the company's underlying strength. The stock is up 15 percent since Mar. 18, the ninth-best performance on the Nikkei, and on May 10, Toshiba announced that profits for the year would climb to a record 140 billion yen ($1.7 billion).

Toshiba can thank Steve Jobs for its recovery. The Japanese company is the world's second-largest producer of Nand flash chips, behind only **Samsung**, and is a major supplier to **Apple** for the iPad. The Toshiba plants in central and southern Japan making those chips were largely unaffected by the earthquake and tsunami. Toshiba Mobile Display, a fully owned subsidiary, makes small LCD panels for the iPhone and other products, and that double play of memory chips and displays puts Toshiba in the electronics industry's sweet spot. "The expansion of Nand and small-panel demand from smartphones and tablets will help support a longer profit recovery for Toshiba," CLSA Asia-Pacific Markets analysts Christian Dinwoodie and Nanako Imazu wrote in a May 12 report.

Chips and displays aren't the only products contributing to Toshiba's revival. The company ranks fifth among the world's PC vendors, and while industry leaders such as **Hewlett-Packard**, **Acer**, and **Dell** struggle with falling shipments, Toshiba's computer business, led by its Portégé laptops, is on something of a roll. Its PC shipments grew in the first quarter by 5.3 percent worldwide, according to data from market research firm Gartner. Of the top five PC vendors, only **Lenovo** grew faster than Toshiba. (Shipments from HP, Acer, and Dell all shrank.) The

Toshiba Inside



DATA: MF GLOBAL; IFIXIT.COM

PHOTOGRAPH BY GIDEON BOAZ FOR BLOOMBERG BUSINESSWEEK

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company did even better in the U.S., with shipments jumping 10.9 percent, second only to Apple's 18.9 percent.

Post-tsunami spending in Japan could give Toshiba a further boost. Fumio Muraoka, corporate senior executive vice-president, told reporters on May 9 that the company expects to benefit from reconstruction demand for TVs, refrigerators, and air conditioners in the current fiscal year. Toshiba also sees growth in demand in some of its other businesses—such as water treatment systems and electrical substations—in the region hardest hit by the disaster.

Can Toshiba keep the turnaround going? For all its strength, the company's semiconductor business has lower profit margins than its South Korean rivals, largely because the strong yen makes Japan a more expensive place to operate chipmaking facilities than Korea. Toshiba also is struggling in some of its other businesses. It lags far behind market leaders **Western Digital** and **Seagate** in disc drives, and while it is strong in Nand flash, it's weak in specialized semiconductors such as logic chips. The non-Nand business "has been bleeding the last couple of years," says David Rubenstein, an analyst in Tokyo with MF Global FXA Securities who would like to see Toshiba jettison its low-margin businesses. "They need to buckle down and cut costs," he says, by outsourcing production to foundries and selling low-margin businesses. That isn't easy in Japan, where companies are used to making things themselves.

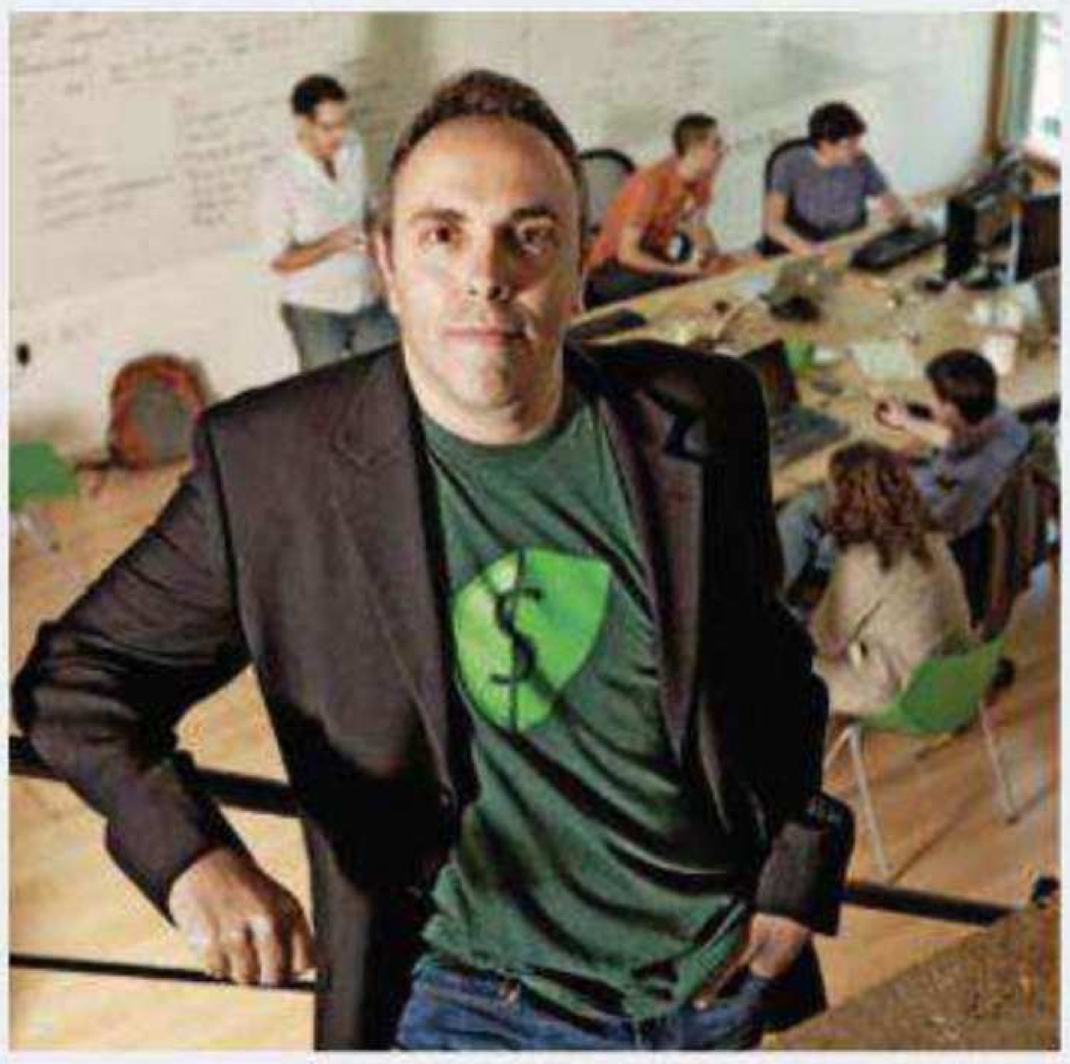
Another big concern is the future of the nuclear business. For now the company can count on a healthy backlog of orders from China, but with the future of nuclear power still uncertain, Toshiba is making moves into other energy sectors. On May 10 it signed a preliminary deal with Charlotte-based clean-energy company **Babcock & Wilcox** to develop thermal and solar technologies. It's trying to become a player in the fast-growing market for smart-grid equipment for electricity networks, too: On May 19, Toshiba announced a $2.6 billion deal to buy **Landis&Gyr**, a Swiss electronic metering company.

—Bruce Einhorn, with Maki Shiraki

The bottom line *Toshiba is making record profits from its chip business. To keep growing, it's moving aggressively into alternative energy technologies.*

Innovator

Credit-Card Cops



Yaron Samid's BillGuard has developed a system that uses technology and crowdsourcing to alert consumers about suspicious credit-card charges

In 2009, Yaron Samid's wife bought concert tickets on ticketmaster.com. On the confirmation page, she clicked a link offering a discount on her next purchase. Six months and approximately $80 later, Samid realized that his wife had also unwittingly signed up for a monthly coupon service from Webloyalty, a company whose controversial tactics have drawn the attention of the U.S. Senate and consumer watchdog forums such as Ripoff Report. (A Webloyalty spokesman says its enrollment process "has been enhanced considerably" since 2009.)

Samid, 38, got to wondering: How can banks and credit-card companies invest so much time and money in spotting obvious fraud but miss what he calls "gray merchants" like Webloyalty, who obey laws but elicit annoyed surprise when they show up on credit-card bills? Samid left his job at Pando Networks, an online video distributor, and hooked up with Raphael Ouzan, a 23-year-old computer whiz who had just finished five years in the Israeli military's cyber squadron.

The product they developed is BillGuard, an online service Samid refers to as a "people-powered antivirus for bills." The site, which launched on May 23, detects suspicious charges. Link your credit or debit card, and BillGuard runs each of your transactions through roughly 100 tests to determine their legitimacy. Some of the tests are algorithmic—a "URL miner," for instance, examines a merchant's Web server to see if it has ever hosted malware; a "complaints miner" searches Twitter and consumer forums for criticism. Other mechanisms rely on aggregated wisdom from BillGuard users who are encouraged to flag bad charges. If enough users cite transactions with a questionable outfit, others will get a warning when that merchant appears on their bill.

Samid comes from a family of brainiacs—his father is a computer scientist, his mother an oncologist. "Those genes skipped over me," says Samid, who flunked his first-year engineering courses at the University of Maryland. Ouzan—"the brain of the company," Samid says—oversees BillGuard's six data scientists in the start-up's Tel Aviv R&D offices, while Samid serves as chief executive officer.

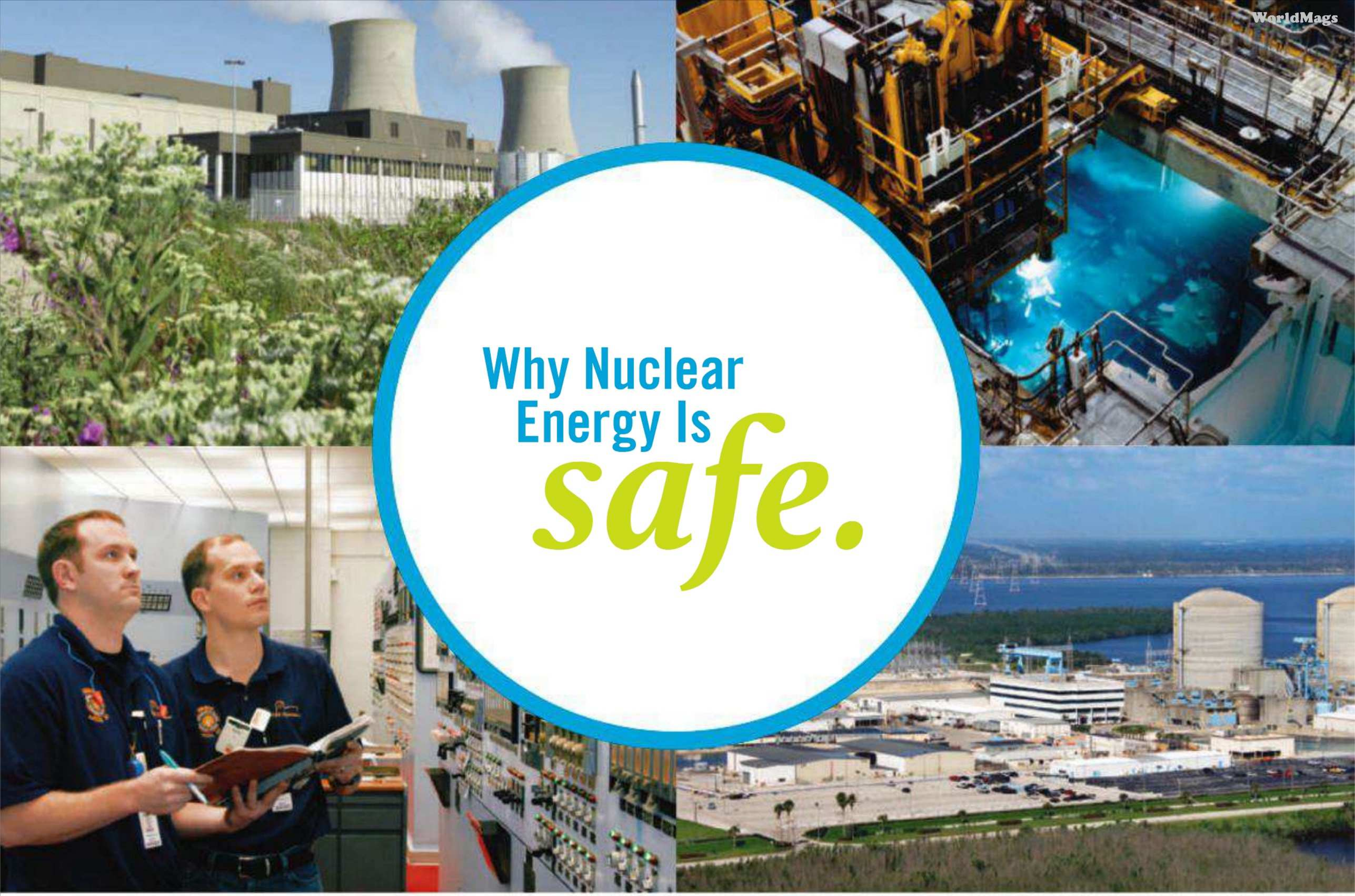
The service is free for users. Samid hopes banks will pay BillGuard to use its algorithms, which could take the place of expensive call center employees and automatically approve or decline refunds for disputed charges. Banks will "save enormous amounts of money because they spend less time dealing with pissed-off customers," says Roger Ehrenberg, a venture capitalist at IA Ventures who contributed to a $3 million round of financing for BillGuard last May. If so much money is at stake, why aren't the banks already doing this? "Banks aren't in the technology business," says Samid. "We are." *—Barrett Sheridan*

Background ▶ **Israeli-born; raised in U.S.; University of Maryland graduate**

Inspiration ▶ **Wife's inadvertent registration for a monthly coupon service**

Rationale ▶ **"Banks aren't in the technology business. We are"**

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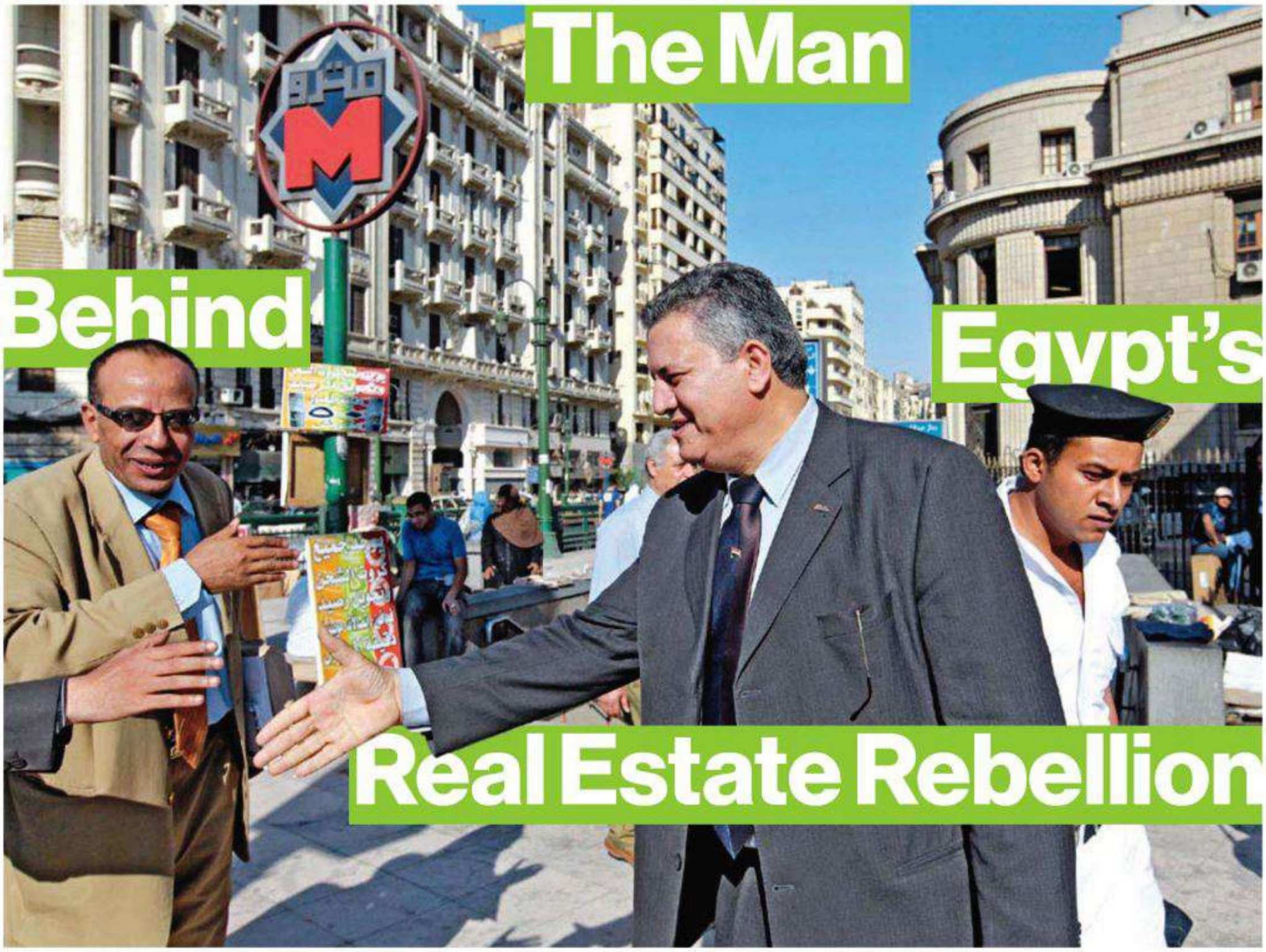
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Markets&Finance

The Man Behind Egypt's Real Estate Rebellion



SHAWN BALDWIN/BLOOMBERG

▶ Lawsuits brought by Hamdy El Fakhrany uncover corrupt land deals

▶ "I'm not against private companies working, but why can't they pay fair prices?"

Hamdy El Fakhrany didn't set out to strike a blow against Egyptian government corruption when he traveled to a state land auction in 2007. All he wanted was a quarter of an acre to build a house. The auction was canceled, as were the others he tried to attend over the next six months, the 53-year-old engineer says.

Finally, an employee at the Housing Ministry took him aside and told him how things worked in then-President Hosni Mubarak's Egypt. "'You are not Hisham Talaat Moustafa,' he told me," referring to the billionaire whose family founded the country's biggest property developer, **Talaat Moustafa Group Holding**. "'If you were, you would have been given 33 million square meters [355 million square feet] of land without an auction, and for nearly nothing.'"

El Fakhrany left the meeting determined to learn as much as he could about the Talaat Moustafa purchase, which occurred in 2005. He was initially barred from reading the contract. Even so, by relying on handwritten notes slipped to him by someone else at the ministry, El Fakhrany was able to build a case that persuaded a court in September to annul the land sale underpinning the 120,000-home Madinaty project on Cairo's outskirts. An appeals court is set to review the ruling on June 21.

El Fakhrany says he has received enough information to file 76 suits challenging 126 projects

The size of the Madinaty deal and the government's attempts to override the September court ruling fed into broader public criticism directed at Mubarak, his family, and corruption in Egypt. A popular uprising forced Mubarak to resign in February after 30 years in power.

The publicity surrounding Madinaty, Egypt's biggest property development, prompted people to provide El Fakhrany with evidence of other suspicious land deals. He says he's now the plaintiff in more than a dozen lawsuits targeting state officials and developers. "I'm not against private companies working, but why can't they pay fair prices?" he says. "Those companies should not be an excuse to loot Egypt."

El Fakhrany has already scored

WorldMags

The best seats in the house page 49 ▶



another legal victory. On Apr. 26 a court reversed a 966,000-square-meter land sale to **Palm Hills Developments**, Egypt's fourth-biggest publicly traded developer, based on a suit brought by El Fakhrany that claimed the price was significantly less than the market value.

The panel of judges that annulled the transaction said that former Housing Minister Ahmed El Maghraby signed the Palm Hills sale document. El Maghraby owned a 4.6 percent stake in **Mansour & Maghraby Investment & Development**, which in turn holds 55 percent of Palm Hills, according to a company filing. El Maghraby has been arrested on charges of squandering public funds and profiteering in connection with the case. He could not be reached for comment.

El Fakhrany is preparing additional lawsuits, saying he has received enough documents to file 76 cases that challenge 126 projects. The contracting business owner says he is working with his daughter, Yasmin, a dermatologist, and using his own income to cover legal costs.

El Fakhrany's campaign, along with the uncertainty stemming from the toppling of the Mubarak regime, has thrown Egypt's real estate industry into turmoil. Stocks of publicly traded developers have tumbled as sales plummet and customers cancel deals. Shares of Talaat Moustafa are down 50 percent this year. In December, El Fakhrany was named "Egypt's First Fighter of Corruption" for 2010 in an event organized in part by the syndicate of journalists in Egypt. He received a prize of 5,000 Egyptian pounds ($840).

As for the Madinaty project that started El Fakhrany on his quest, a court order finally made the development's land contract available for review. While El Fakhrany knew some of the details, he was shocked when he read the document closely. Under the 2005 deal, which was completed without a public auction, El Fakhrany says, the state was entitled to 7 percent of the residential properties built, while Talaat Moustafa would get 93 percent. The government also agreed to exempt the developer from all taxes and fees incurred during construction, including import duties on construction materials, and relinquished rights to any commercial or retail space. "The deal couldn't have been any more slanted on the side of the developer and against Egypt," El Fakhrany says. "It was like it was drafted by an enemy of the state." While investigating the Madinaty case, El Fakhrany discovered that a Cayman Islands-based fund called **Horus Private Equity Fund III** was a shareholder in Talaat Moustafa Group and lists Mubarak's son Gamal as one of its owners.

Jihad Alsawaftah, chief financial officer at Talaat Moustafa, didn't respond to calls and e-mails seeking comment. Construction on the site continues while the case is in court. Hisham Talaat Moustafa, the former chairman of Talaat Moustafa, was convicted in May 2010 of paying a former police officer to kill his former girlfriend, Lebanese pop singer Suzanne Tamim. His sentence was reduced from death to 15 years in prison after a retrial that ended in September.

During an interview in a Cairo cafe, a woman approached El Fakhrany and asked if she could contact him and provide some documents to review. She thanked him for his work. "All the land, which was acquired through corruption, must be returned to the country, or those companies must pay the fair value for it," El Fakhrany says. "Only then we will settle and let the projects go on."

— Zainab Fattah and Mahmoud Kassem

The bottom line *El Fakhrany's challenges to land deals in Egypt are uncovering corruption and upending the real estate market.*

Mergers

The Best Dealmaker You've Never Heard Of

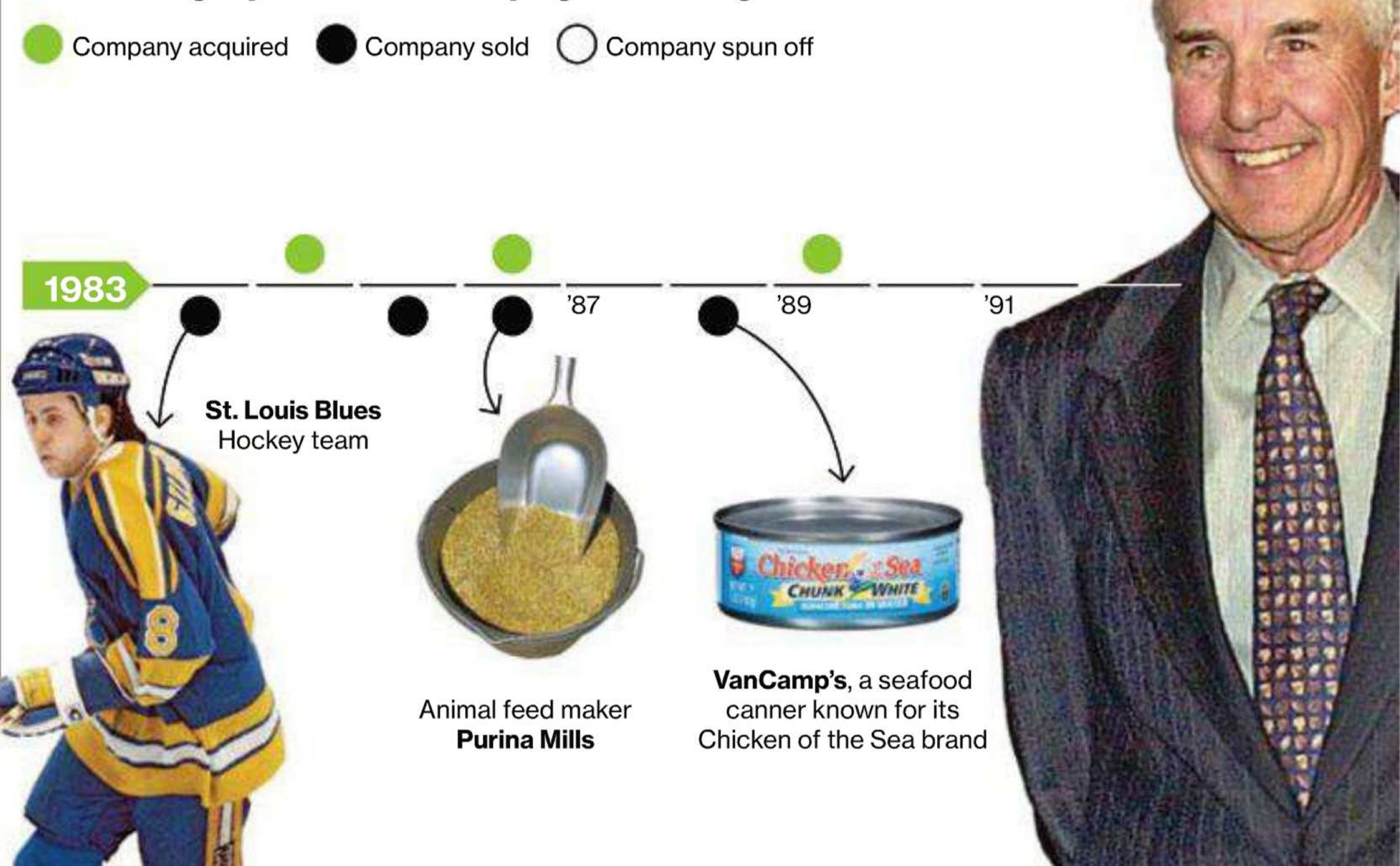
▶ Bill Stiritz of Ralcorp has bought and sold dozens of companies

▶ "He's a Warren Buffett-like character"

Since March, William P. Stiritz, the chairman and chief dealmaker of **Ralcorp Holdings**, has spurned two unsolicited takeover offers from **ConAgra Foods**. If Stiritz, 76, squeezes a higher price from ConAgra and changes his mind—which analysts including BB&T's Heather Jones say is likely—the sale would cap three decades of dealmaking. "He's probably among the best moneymakers of the past 30 years," says John McMillin, a food industry analyst at Prudential Securities from 1985 to 2007. "He's right up there with [former **Nabisco** and **Gillette** Chief Executive] Jim Kilts and **Colgate**'s Reuben Mark. He's a Warren Buffett-like character, but stays out of the limelight."

Stiritz, who declined to comment for this story, became chief executive of Ralcorp's predecessor in 1981. Back then, Ralston Purina was a mishmash of unrelated businesses, including the St. Louis Blues hockey team and a mushroom farm. Stiritz jettisoned every piece of Ralston Purina that did not fit his vision of a top-notch consumer products company, including the animal feed business that

Stiritz's Legacy: 30 Years of Buying and Selling



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had been the company's core since its founding in 1894. "He's a focused, numbers-driven guy," says Jim Nichols, who worked for Stiritz for more than 25 years at Ralston and Ralcorp. "He has little emotional attachment to companies."

Raised by his grandparents in rural northwest Arkansas, Stiritz earned a master's degree in European history from St. Louis University in 1968. After working at a St. Louis ad agency, Stiritz joined Ralston Purina as a marketing executive and worked his way up the ranks. As CEO, he concentrated on strategy. "Was he charismatic? No. But he was brilliant," says Nichols. "He was three or four moves ahead of his peers."

Stiritz sold parts of Ralston and added others such as Eveready Battery, maker of Energizer, which he bought from **Union Carbide** in 1986. In 1989 he bought Beech-Nut, a baby food maker that lagged industry leader Gerber and had lost money for years. Stiritz cut costs, jazzed up marketing, and turned Beech-Nut around. Five years later, he spun off Ralston Purina's cereal, baby food, and other units into Ralcorp. Stiritz chaired Ralcorp's board and remained chairman and CEO of Ralston Purina. In 2000, he spun off **Energizer Holdings**, the battery business, and served as chairman until 2007.

In 2001, Stiritz sold Ralston Purina—by then just a pet-chow business—to **Nestlé** and focused on building Ralcorp. He expanded into nuts, sauces, and frozen foods, then acquired Post, maker of Grape-Nuts, from **Kraft Foods** in 2008. Last year Stiritz paid $1.2 billion for American Italian Pasta, which makes store-brand spaghetti for **Wal-Mart Stores** and other grocers.

Today Ralcorp generates $4 billion in sales, three-quarters of it from private-label cereal, pasta, sauces, and other foods. Sales in the first half of its 2011 fiscal year rose 20 percent, and on May 2 the company forecast full-year profit that surpassed analysts' expectations, fueled by the performance of those acquisitions. Over the 10 years through Apr. 28, Ralcorp stock rose 356 percent, compared with 100 percent for the Standard & Poor's 400 MidCap stock index, of which Ralcorp is a component. That doesn't count the 23 percent surge to $87.79 from Apr. 29 to May 24 fueled by the ConAgra takeover talk. Those who have worked and invested with Stiritz say he'll sell Ralcorp to ConAgra eventually, once he gets the price he's after—somewhere between $92 and $100 per share. "There's a willingness to do a deal," says Jack Murphy, senior portfolio manager at Levin Capital Strategies, which owns Ralcorp shares. ConAgra declined to comment.

"This is his last hurrah, so he's pushing for everything he can get," says Nichols, the former Ralcorp executive. "Nobody would have looked at Ralcorp in 1994 and imagined that, 17 years later, it would be a $100-a-share business. Nobody."—*Matthew Boyle*

The bottom line *If he gets the right price, dealmaker Stiritz may sell Ralcorp to ConAgra. The stock is up 23 percent since Apr. 29 on takeover chatter.*

Energy

Tony Hayward Gets His Life Back



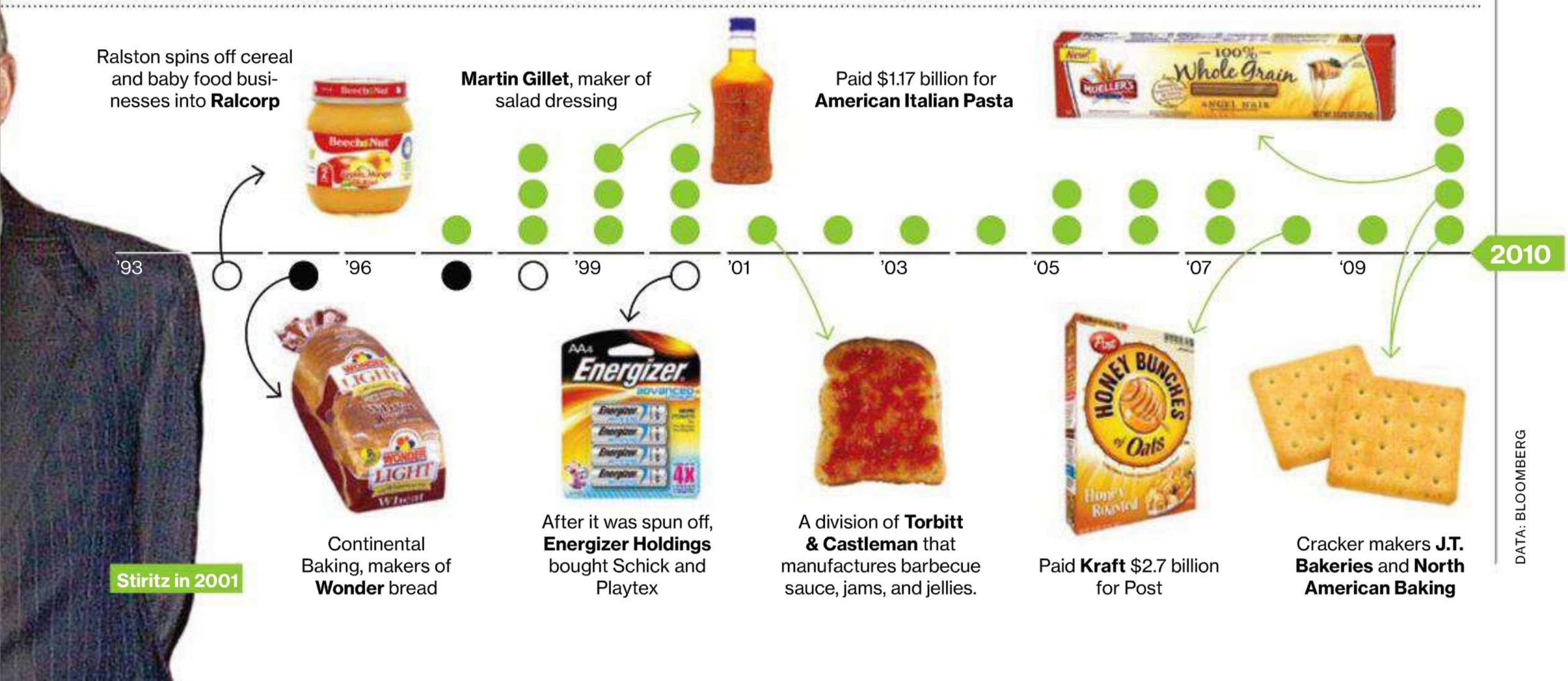
▶ The former head of BP is launching a new venture in the oil business

▶ "I would invest my own money with him," says an analyst

As chief executive officer of **BP**, Tony Hayward presided over the worst oil spill in U.S. history, which led the company to take $41 billion in charges. Now he's preparing to immerse himself in the energy industry again.

Hayward stepped down as BP's CEO on Oct.1 , 2010, after being roundly attacked for comments he made the previous spring, as the Macondo well in the Gulf of Mexico was still spewing oil. "No one wants this thing over more than I do," he said. "You know, I would like my life back." The N.Y. *Daily News* called Hayward "the most hated—

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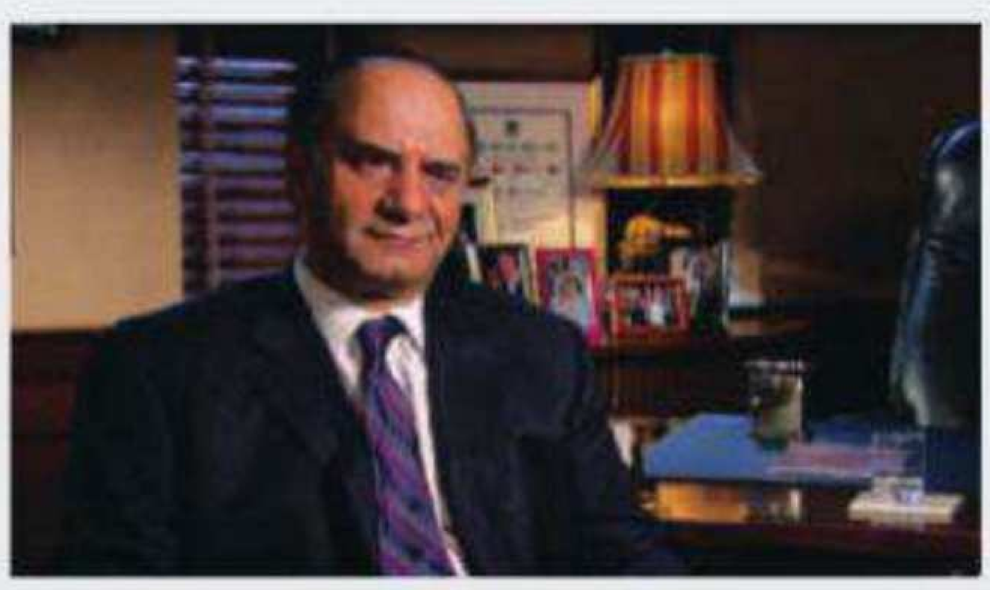
HAYWARD: SIMON DAWSON/BLOOMBERG; ALAMY (5); GETTY IMAGES (2)

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and the most clueless—man in America."

That was not to be his last turn running an energy company. Hayward, 54, and financier Nathaniel Rothschild, 39, are launching a new company, **Vallares**, to acquire a stake in an oil or gas field. They are modelling the company on **Vallar**, a company Rothschild founded in 2010. Rothschild used Vallar, which trades on the London Stock Exchange, to acquire stakes in two Indonesian coal mining companies for $3 billion in cash and shares in November.

Credit Suisse and **JPMorgan Chase** are advising Hayward on an initial public offering for Vallares. Hayward hopes to raise at least 1 billion pounds ($1.6 billion), according to three people with knowledge of the matter, who declined to be identified because the plans are not public. The offering could take place in late June or July, according to one of the people.

"I'm not sure Tony Hayward brings much credibility to a project like this," says Colin McLean, CEO of SVM Asset Management in Edinburgh, noting that starting a company is different from running an established giant. Admirers say Hayward's contacts, experience, and expertise as a geologist still offer lots of value. "He brings tremendous insight and information," says Fadel Gheit, an oil analyst at Oppenheimer & Co. in New York. "I would invest my own money with him."

Hayward and Rothschild recently sounded out investors in Abu Dhabi, Qatar, the U.S., and the U.K. They received expressions of interest for the full $1.6 billion they want to raise, people with knowledge of the matter say.

Despite his record at BP, Hayward is hardly an industry pariah—in fact, he still has a job at BP. After he stepped down, the company appointed him to the board of TNK-BP, its joint venture with three Russian oligarchs. He also serves on the board of **Glencore International**, the Swiss commodities trader founded by Marc Rich. According to a company spokesman, Hayward was brought in as an expert on the oil industry in time for the initial public offering on May 19 that valued the company at $59 billion. —*Brett Foley and Stanley Reed, with Jesse Riseborough*

The bottom line *Less than a year after resigning as CEO of BP, Hayward is planning to raise $1.6 billion for a company that will invest in the oil industry.*

Payments

Banks' New Money Machine: Prepaid Cards

▶ Cards are replacing checks for payroll and government benefits

▶ "It's more convenient, and you get your money faster"

Gus Artiles used to wait anxiously for the mail carrier on Friday afternoons, hoping his California state disability insurance check would arrive before his bank closed for the day. Now Artiles, 54, doesn't worry about the mail. By Friday morning, **Bank of America** automatically loads his funds onto a prepaid card, which Artiles uses to buy groceries and gas like a regular debit card. "It's a beautiful thing," he says. "It's more convenient, and you get your money a lot faster."

Artiles is one of almost 2 million people taking part in "one of the largest prepaid programs on the planet," says William M. Sheedy, the head of **Visa**'s Americas group, referring to California's effort to use prepaid cards for unemployment benefits, disability insurance, and paid family leave programs. Such demand from governments as well as employers is helping power the prepaid card market. Last year, people used prepaid cards for $65 billion in transactions, up from $48 billion in 2009, according to the *Nilson Report*. Sanjay Sakhrani, an analyst at KBW, estimates that would have generated about $1 billion in transaction fees for card issuers. That comes as banks look for ways to replace the $25 billion in projected lost revenue that recent credit and debit card reforms may cost them, according to Boston Consulting Group.

$65 BILLION



Value of U.S. transactions using prepaid cards in 2010.

While the prepaid market includes cards sold directly to consumers in drugstores and other retail outlets, large banks see issuing cards for government benefits and employers' pay-

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STEVE REINTS
Director, Teradata

PIERRE JOYAL
GE Capital

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imagination at work

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Quoted

"This is not something we even consider investing in... This is a sideshow. It's a magic show. The only question for the investor is how soon they should sell."
—Lawrence J. Haverty Jr. of Gamco Investors, commenting on LinkedIn. The stock more than doubled on May 19, its first day of trading.



rolls as a growth opportunity. Tim Wall, head of **Citibank**'s prepaid sales, says using cards instead of cutting and mailing checks can trim costs by 75 percent. "We're just at the beginning of many of our government clients moving from paper to a paperless environment," says Margaret A. Scopelianos, a treasury services executive at Bank of America.

Issuing prepaid and debit cards is a high-volume, low-margin business, in which banks collect two types of fees. They get money from the payment networks that charge retailers swipe fees when consumers use the cards to make a purchase. While financial reform capped such fees for debit card transactions, Congress did not limit them for most prepaid cards. That exemption will be a "positive thing" for the prepaid market, says Citi's Wall. As they do with debit cards, banks also may charge users for such things as making multiple ATM withdrawals, using a non-network ATM, or overdrafts.

Because of the project's scale, California was able to negotiate a program that has almost no fees for consumers, something that was "paramount" after learning other states had less favorable deals, said Loree Levy, a spokeswoman for the California Employment Development Dept. **JPMorgan Chase**'s prepaid cards for Michigan's unemployment insurance charge $1.50 for each denied transaction, for example, and **U.S. Bancorp**'s cards in Ohio charge $17 for each overdraft.

Consumer advocates have a love-hate relationship with prepaid cards. The cards help the estimated 60 million Americans who, either by choice or circumstance, don't regularly use bank accounts and instead depend on costlier check-cashing services and payday loans. Yet fees add up quickly and are painful for lower-income consumers. Earlier this month, the National Consumer Law Center graded all 40 states that use prepaid cards for unemployment compensation, noting 13 particularly "problematic" state programs that had heavy consumer fees.

Similarly, consumer advocates and the prepaid industry trade organization recently issued a set of 10 "joint principles" for prepaid payroll card fees. The industry says the increased consumer pressure, combined with more competition, means "fees are dropping and becoming more simplified in their structure," says Brian Triplett, Visa's head of prepaid products.

More prepaid programs are on the horizon. The number of workers receiving prepaid payroll cards from their employers will double to 5.4 million by 2014, according to estimates by market research firm Aite Group. And the federal government is embracing the approach. This year the Treasury Dept. ran a pilot program to put tax refunds on prepaid cards. Starting in May, new Social Security recipients must choose between direct deposit or prepaid cards from **Comerica Bank**, retiring the paper check entirely.
—Karen Weise

The bottom line *Prepaid cards may help banks replace some of the estimated $25 billion in revenue they will lose to debit and credit card reforms.*

Investing

Global Brands Flock To Hong Kong for IPOs

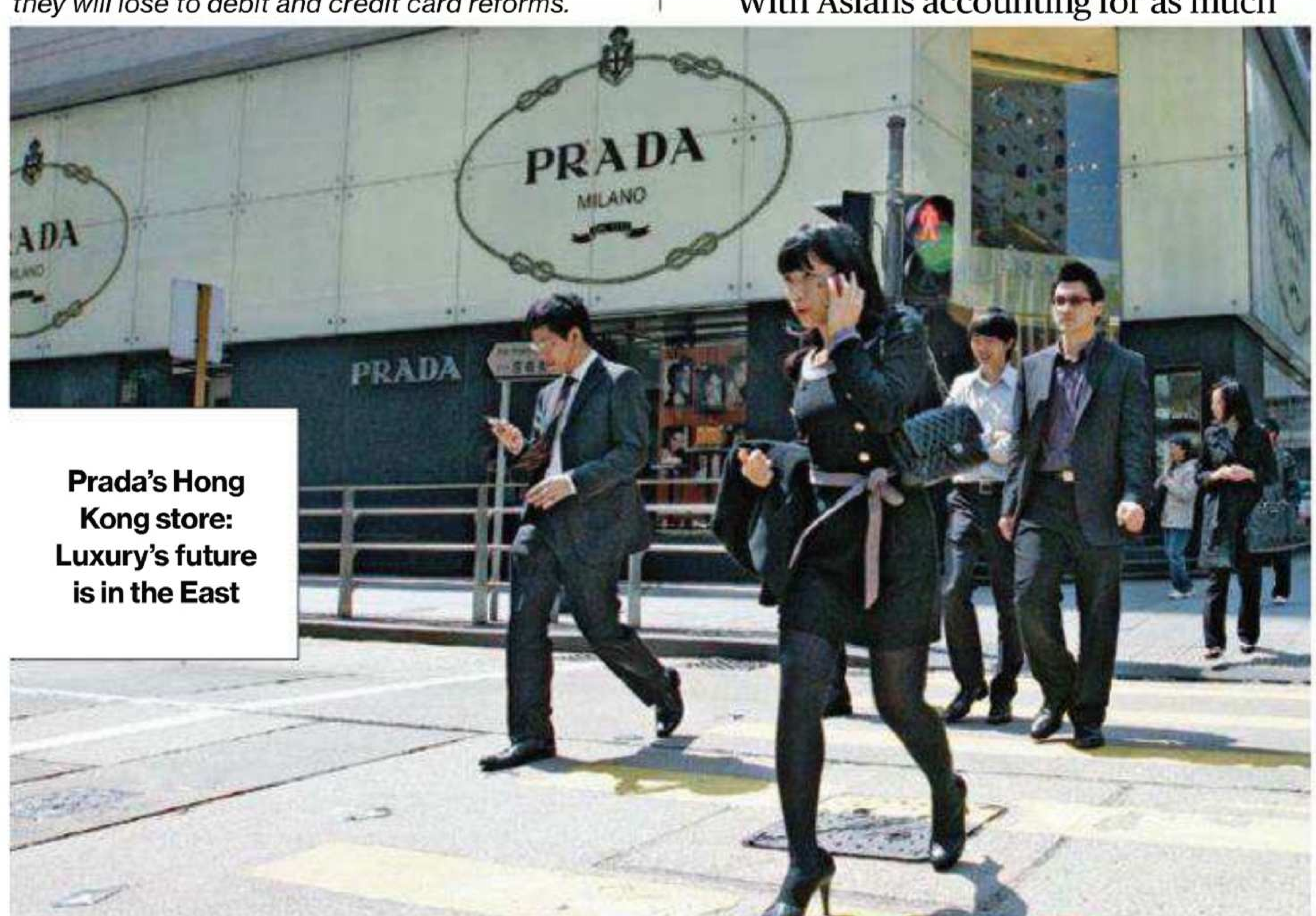
▶ They're selling stock to the people who buy their luxury goods

▶ "Companies want to face their future, not their past"

Prada, the Milan-based luxury goods house, is expected to list its shares in Hong Kong in a $2 billion initial public offering on June 24. Prada will follow on the success of organic cosmetics and skin-care maker **L'Occitane Internationale**, which raised $840 million in Hong Kong last year. Prada's choice of the Hong Kong stock exchange over bourses in Milan, London, and New York is more evidence that the globe's economic center of gravity is shifting to Asia. "Companies want to face their future, not their past," says Sam Kendall, head of equity capital markets for Asia-Pacific at UBS.

The flurry of international listings is helping Hong Kong boost its IPO tally. In 2010, companies raised $51.8 billion through 95 IPOs on Hong Kong's stock exchange, compared with a total of $48.22 billion in 196 deals on the New York Stock Exchange and Nasdaq. So far this year, 25 IPOs in Hong Kong have raised $7.7 billion.

With Asians accounting for as much



Prada's Hong Kong store: Luxury's future is in the East

WorldMags

as 50 percent of luxury sales globally, a Hong Kong listing is a no-brainer, says Aaron Fischer, head of consumer and gaming research at brokerage CLSA Asia-Pacific Markets. The growth prospects for its business in Asia is the main reason **Samsonite** chose Hong Kong for its IPO, say people involved in the deal who asked not to be quoted prior to the June listing. The world's largest luggage brand, owned by London-based CVC Capital Partners and the Royal Bank of Scotland, projects Asia will account for half its profits by 2012. **Coach**, the largest U.S. handbag maker, trading on the New York Stock Exchange, plans to list shares in Hong Kong, in the form of depositary receipts, before the end of the year to "raise awareness of the Coach brand among investors and consumers in the China market," said Chief Executive Officer Lew Frankfort in a statement.

Another attraction of Hong Kong is that it allows investment banks to make deals with wealthy investors to buy shares before marketing the IPO to the public—a practice not allowed in the U.S. Such "cornerstone" investors agree to hold their shares for six months after buying at the offering price. Their participation can make it easier to build enthusiasm for the offering. "The retail guys are very affected when they see some billionaire willing to lock himself in for six months," says George Lin, an investment banking executive at Credit Suisse. **MGM China**, which is hoping to raise as much as $1.5 billion by listing its Macau operations in Hong Kong on June 3, signed Kirk Kerkorian and Hong Kong property magnate Walter Kwok, according to the prospectus.

It isn't just consumer brands heading to Hong Kong. The world's largest aluminum producer, **United Company Rusal**, raised $2.1 billion in 2010, and Swiss commodities trading group **Glencore International** allocated 2.7 percent of its $10 billion global IPO in May to Hong Kong retail investors. "A Hong Kong listing will raise the profile with all the suppliers and customers we deal with over there," says Glencore CEO Ivan Glasenberg. "We thought it was very important to be involved in this region." Ⓑ —*Frederik Balfour*

***The bottom line** Hong Kong is becoming a market of choice for global companies selling shares to the public, with 25 IPOs raising $7.7 billion this year.*

OPPOSITE PAGE, BOTTOM: ALEX HOFFORD/EPA; BLOOMBERG (5); GETTY IMAGES

Bid & Ask

by Caroline Winter



1. Japan's **Takeda Pharmaceutical** agreed to buy Zurich-based Nycomed for $9.1 billion, in part to cushion the blow of losing patent protection on Actos, its best-selling diabetes pill.

2. The U.S. Treasury Dept. and **American International Group** raised $8.7 billion in a sale of AIG shares, bringing the insurer one step closer to independence after its 2008 bailout.

3. **Thermo Fisher Scientific**, the No. 1 maker of lab instruments, is buying Sweden's Phadia for $3.5 billion to expand in testing for allergies and autoimmune diseases.

4. Hungary's government is paying $2.7 billion to Russian oil producer Surgutneftegas for its 21.2 percent stake in Hungary's largest oil refiner, **Mol**, to thwart a takeover by Surgutneftegas.

5. **Toshiba** will pay $2.3 billion for Swiss electronic metering company Landis & Gyr to bolster its smart power-grid operations.

6. Malaysian billionaire Robert Kuok offered to buy all the shares in **Allgreen Properties** through his firm Brookvale Investments, valuing the developer at $2 billion.

7. Moscow-based **Yandex**, the owner of Russia's most popular search engine, raised $1.3 billion in a U.S. IPO that values the company at about $8 billion.

8. Labelux, the privately held luxury group that owns Bally, agreed to buy shoe company **Jimmy Choo** from TowerBrook Capital Partners for $811 million.

9. Canada's **Valeant Pharmaceuticals International**, maker of CeraVe cleansers and creams, is buying Lithuania-based Sanitas for about $442 million to add dermatology drugs and expand into Eastern and Central European markets.

10. **Elizabeth Taylor's** estate is asking $8.6 million for the five-bedroom Bel-Air home where the star lived until her death in March.

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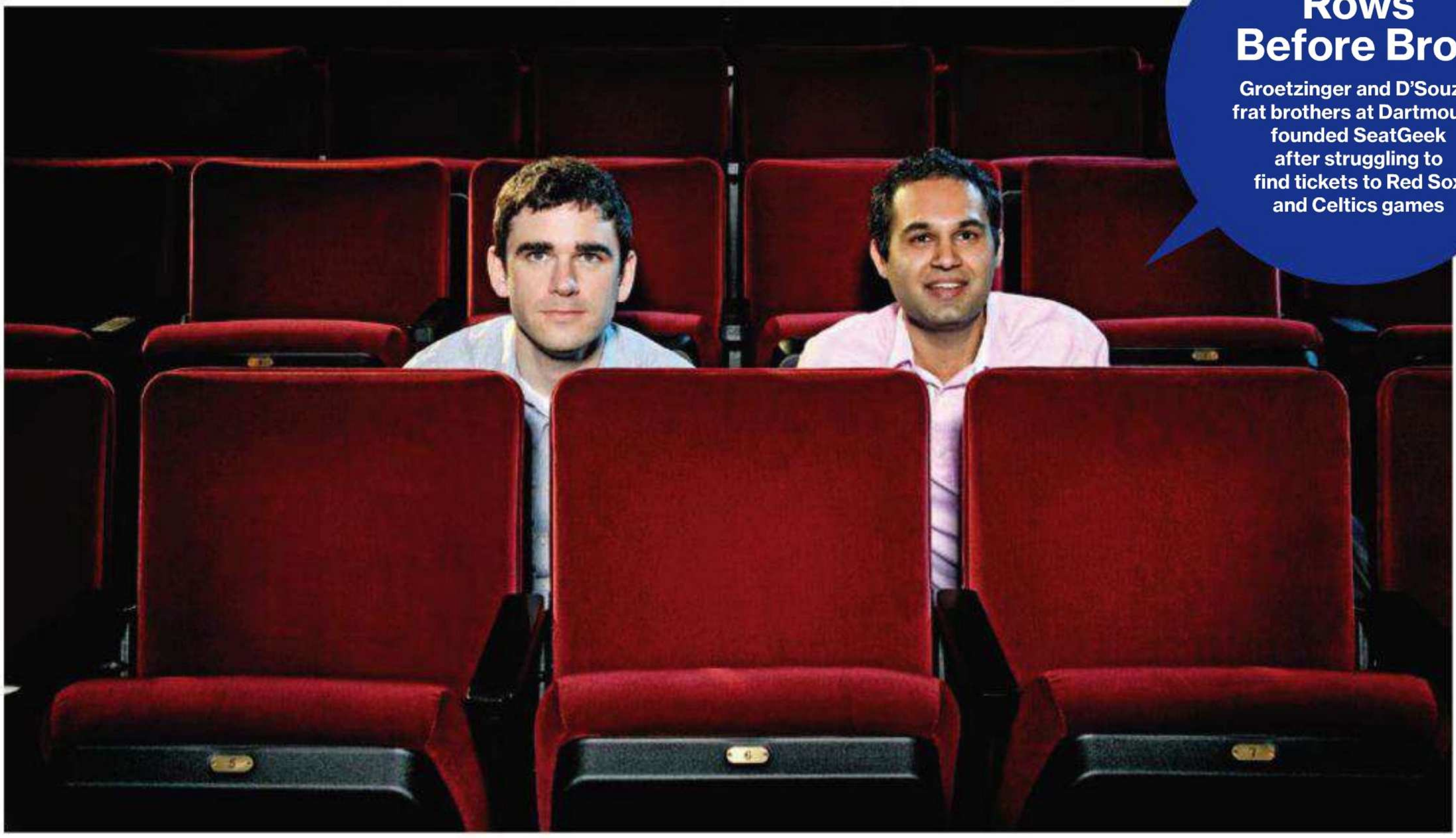
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Contents ▶ SeatGeek picks the best summer concert deals 50 ▶ IPhone games shoot for the silver screen 51 ▶ The next Tarantinos turn to Kickstarter for funds 52 ● Edited by Barrett W. Sheridan

Focus On

Entertainment Tech



Rows Before Bros

Groetzinger and D'Souza, frat brothers at Dartmouth, founded SeatGeek after struggling to find tickets to Red Sox and Celtics games

PHOTOGRAPH BY KAREEM BLACK FOR BLOOMBERG BUSINESSWEEK

How to Keep Your Head Among Scalpers

▶ **Startup SeatGeek uses data to find deals on secondhand sports and entertainment tickets**

▶ **Ticket resellers assume that "many consumers are not strategic"**

Tickets to see the Milwaukee Brewers play a home game on a Wednesday night—ideally for the last game of a series—could be the best deal in Major League Baseball. That's the perfect combination of factors that leads to a bargain, according to two-year-old startup **SeatGeek**. The number-crunching website aggregates sports and entertainment tickets available on resale sites such as **StubHub**, then mixes together millions of data points, some brainy algorithms, and an easy-to-use interface to help fans find the best deal possible.

The process of buying tickets on the secondary market can be maddening. Fly-by-night vendors and a lingering air of illegality—sidewalk scalping is still against the law in many states, while scalping online is not—make it hard to know whom to trust, while price gougers make it tough to find a good deal. Resellers change ticket prices seemingly at random in a way that maximizes their revenue and assumes "many consumers are not strategic," says Andrew T. Sweeting, a Duke University economics professor. Primary ticket sellers are getting in on the act, too, with **Ticketmaster**, sports teams, and event promoters experimenting with variable pricing. "It's kind of overwhelming, the malice people have toward ticketing,"

Ticket buyers "constantly feel like they are getting ripped off," says co-founder Groetzinger

says SeatGeek co-founder Jack Groetzinger. "They constantly feel like they are getting ripped off."

Groetzinger and his co-founder, Russell D'Souza, both 26, came up with the idea for SeatGeek in 2008 and launched the site a year later. The former fraternity brothers were living in Boston and wanted to see the Red Sox and the Celtics play. Tickets for both teams are scarce, and the college buddies were "overwhelmed by the bad experience of buying online," Groetzinger recalls. They ended up spending hours bouncing among different reseller sites, waiting to find the best prices. Data, they thought, might bring transparency to the black hole of ticketing.

Sites such as **Kayak** and **Orbitz** have long aggregated and helped

Entertainment Tech

buyers sort through airline deals. A startup called Farecast used historical data to predict changes in air travel ticket prices starting in 2006. (In 2008 it was bought by **Microsoft**, which uses the technology in its Bing search engine.) Groetzinger and D'Souza quickly learned that making sense out of event tickets is trickier than in air travel: While every coach ticket on an airplane is more or less the same, seats for events can vary greatly.

Searches on their site yield a list of most of the available aftermarket tickets displayed on a large dynamic map of the venue. Overlaid on the map is SeatGeek's key feature: a "Deal Score" that rates each ticket. A big green dot over a seat means it's a bargain; a small red dot, not so much. Want to see Taylor Swift in Hartford on June 22? The $90 seat in Row V of the nosebleed section is a great value, as are the $195 tickets in front of the stage. Glancing at the map, users quickly understand that "there are still good deals to be found," says D'Souza.

Behind the scenes, the color-coded dots are powered by SeatGeek algorithms that take into account such factors as how far a seat is from home plate or the angle of a view to the stage, and what Groetzinger calls the "irrational premium" fans put on sitting in the first row of a section. Equally important is how the price compares with historical data for similar concerts and seats at the venue. For sports events, SeatGeek takes into account a team's win-loss record, how far the game is into a season, and even weather forecasts to determine how in-demand a ticket will be.

SeatGeek's main rival, **FanSnap**, uses a simpler formula to create a short list of top deals for each event instead of evaluating every available ticket. "If it's not worthy, it does not get listed," says FanSnap spokesman Christian Anderson. Tom Davis, who co-founded a similar startup that closed last year after a co-founder passed away, says that at one point about a dozen sites tried to aggregate event tickets. Now, "aside from SeatGeek, a lot of them have just frozen in time," he says.

Like Kayak and similar airline ticket aggregators, SeatGeek doesn't sell tickets directly but instead links to the seller's site, like StubHub or **EBay**. The sites then pay SeatGeek a commission of 9 to 10 percent of each transaction. SeatGeek won't discuss its revenues but says the average customer buys 2.5 tickets totaling $250 to $300. It has raised a total of $2.3 million in funding and now has 12 people on staff—its corner of a shared office in Manhattan is overflowing. "It sounds ridiculous, but I think we have about 18 million tickets on SeatGeek at any given time," says D'Souza.

The founders say their data analytics have been so well-received that at one point they planned on selling the information back to resellers, who wanted to use it to price tickets more strategically. But SeatGeek shelved that idea. As Groetzinger says, "It's a little tricky to play both sides." —*Karen Weise*

The bottom line *SeatGeek uses data including a team's win-loss record and weather forecasts to help fans value tickets before they buy.*

Top Summer Deals

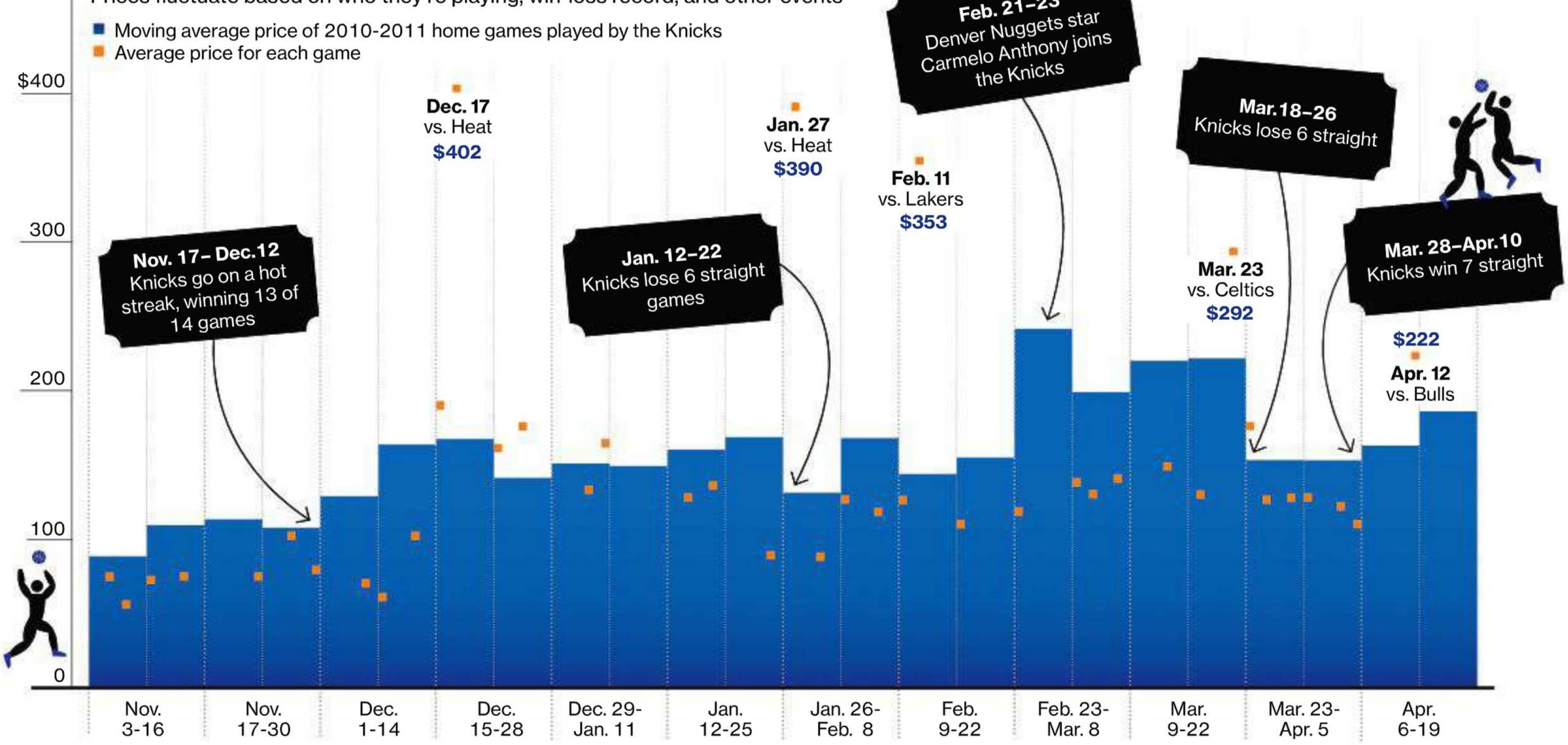
Date	Act / City	Discount from expected price*
6/29/11	**U2** Miami	59%
6/18/11	**Jimmy Buffett** Mansfield, Mass.	34%
6/15/11	**Rihanna with Cee Lo** Chicago	38%
6/01/11	**Glee Live!** Minneapolis	34%
5/30/11	**New Kids on the Block & Backstreet Boys** Uncasville, Conn.	37%

*REFERS TO BEST DEAL ON A SINGLE TICKET; DATA: SEATGEEK

The Value of a Knicks Ticket

Prices fluctuate based on who they're playing, win-loss record, and other events

DATA: SEATGEEK



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Apps

Even Angry Birds Need an Agent

▸ Makers of hit mobile games are moving into toys, films, and more

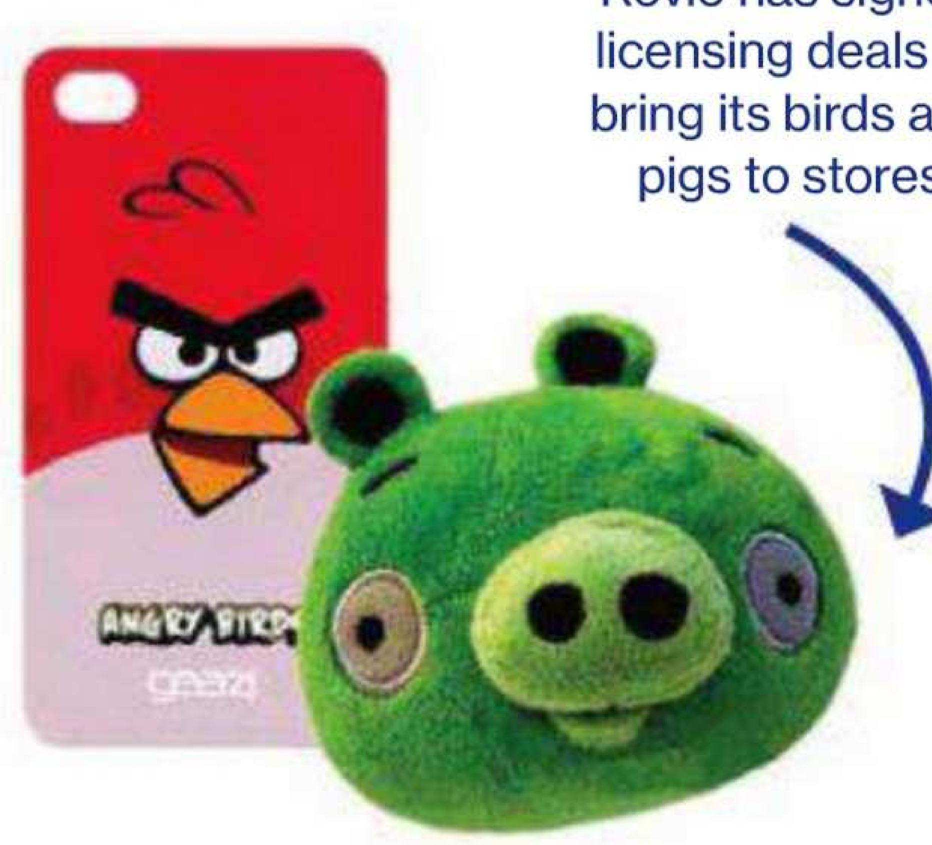
▸ "Mickey Mouse is one of our role models" says a developer

Merchandise? Apps-olutely!
The expanding commercial empires of iPhone gamemakers



Doodle Jump
The game's main character now has a line of T-shirts, key chains, and more

Talking Ben
Outfit7 plans plush toys and agency representation for its iPhone character



Angry Birds
Rovio has signed licensing deals to bring its birds and pigs to stores

Entertainment conglomerates such as **Walt Disney** spend billions developing popular franchises. However, they've had mixed success translating those film, television, and theme park characters to smartphones, where more and more eyeballs are glued. The makers of some popular iPhone games are hoping they'll have an easier time going in the opposite direction, and are trying to launch cross-media franchises based on their hit digital characters. "The new entertainment medium is apps," says Paul A. Baldwin, chief marketing officer of Palo Alto (Calif.)-based **Outfit7**, whose Talking Tom app has been downloaded 50 million times.

Helsinki-based **Rovio Mobile**, with its popular Angry Birds game, may be the best known of the wannabe Disneys. "Mickey Mouse is one of our role models," says Peter Vesterbacka, a co-founder. Rovio and its rivals are now trying to build empires that span toys, clothing, greeting cards, TV shows, and movies. Outfit7's series of talking animal characters, **Mind Candy**'s Moshi Monsters, and **Lima Sky**'s Doodle Jump have each proven popular enough to sell tens of millions of app downloads as well.

Outfit7 introduced its hit app Talking Tom last June. It features a gray tabby that drinks milk and purrs when users scratch an iPhone's screen. Ten other talking characters have followed, including Ben, a gruff dog that likes to blow things up in his chemistry lab. Licensing and merchandising opportunities are part of the business plan, not an afterthought, says Baldwin. In 2002, when he was vice-president of marketing at **Eidos Interactive**, Baldwin struck a first-of-its-kind deal for **Creative Artists Agency** to represent one of Eidos's video game characters, Lara Croft of the Tomb Raider series. The deal led to two movies starring Angelina Jolie. Talking Tom and Talking Ben will have similar representation, Baldwin says, and four manufacturers have approached him to create a line of plush toys based on Outfit7's characters. He declined to name them because the company is still in negotiations. Last year, Rovio hired former CAA agent Peter Levin to help boost its chances in Hollywood.

One of the advantages of building a franchise based on casual smartphone games is that the characters tend to have a broad demographic reach. "Some of these properties are hitting all age groups, all demographics at once," says Michael S. Stone, chief executive officer of brand and trademark management agency **Beanstalk Group**, which is advising Outfit7 and Mind Candy on licensing deals with traditional media companies. And since 99¢ games require little investment and are often spur-of-the-moment purchases, they spread virally, requiring little formal advertising. "The big advantage that small companies have is this amazing ecosystem that **Apple** created," says Igor Pusenjak, a co-founder of Lima Sky. "You get a direct connection to consumers who are more influenced by friends than million-dollar ad campaigns or promotions."

Mobile entertainment companies can develop new characters for a fraction of what it costs to make a movie. To create Doodle Jump, Pusenjak and his brother Marko invested $1,000 in a laptop, $100 in Apple's software kit for developers, and a few weeks' effort. The 99¢ game lets players guide Doodle the Doodler on a journey up a series of platforms, using the tilt controls of the iPhone, iPod touch, or iPad to jump obstacles. Downloaded more than 10 million times, it has spawned a line of T-shirts, mugs, key chains, and posters.

Barry Cottle, executive vice-president of video game giant **EA Interactive**, says established entertainment companies like his have the experience necessary to turn an idea into a franchise, "whereas it's harder for the small developers to get that level of scale quickly." At an analyst conference in February, Disney said it was able to generate $7.3 billion in retail sales based on last summer's *Toy Story 3*.

Old and new media have learned to work together in some cases. **Twentieth Century Fox** partnered with Rovio for a special edition of the Angry Birds game featuring characters from the studio's *Rio* animated film. For *Hop*, a **Universal Pictures** comedy about a rabbit, Lima Sky built a bonus level into Doodle Jump

The U.S. Postal Service: A total wreck? page 60 ▶



that lets users play as the film's main character. Once there's a relationship between consumers and a character in one medium, "it's easy to think about extending that into different mediums," Baldwin says. —*Cliff Edwards and Ronald Grover*

The bottom line *Mobile developers are hiring licensing experts and agents to give their characters lives beyond iPhones and a chance at big profits.*

Film

The Next Indie Darling, Courtesy of the Crowds

▶ Kickstarter helps small filmmakers crowdsource six-figure sums

▶ Relying on studios "means getting a lot of cooks in your kitchen"

Steve Taylor's first feature, *The Second Chance*, was a drama about an encounter between two pastors. It cost $1.2 million to make, was sold to **Sony Pictures** for $1.5 million in 2006, took in a respectable $500,000 at the box office, and had a profitable afterlife on DVD. Taylor figured his next project, an adaptation of Christian writer Donald Miller's best-selling memoir, *Blue Like Jazz*, would be an easy sell. He spent four years pitching investors, and by last September thought he'd locked up financing. "We had a guy in Seattle who was going to come in for $250,000 and then another guy in L.A. who was going to come in for $250,000," Taylor says. On the eve of preproduction, the California investor dropped out, and Taylor considered the project dead.

When Miller broke the news on his personal blog, two fans in Tennessee stepped forward offering to raise the needed funds on the website **Kickstarter**. Founded in 2009, Kickstarter is an online fundraising platform for creative projects. Musicians, designers, filmmakers, and other artists craft a short pitch, usually a video, post it on the site, and set a fundraising target and a time frame. Contributors are more like donors than investors, since they earn no return or equity, though they are promised rewards (a copy of the CD, dinner with the artist). If the project meets its goal, Kickstarter, a for-profit company, takes a 5 percent cut and the creator gets the rest. If it falls short, no money changes hands.

Kickstarter has emerged as a legitimate option for financing independent films, where a six-figure project is on the low end. So far, the company has raised more than $21 million from nearly 240,000 backers for 2,443 films, according to co-founder Yancey Strickler. He says six films have crossed the $100,000 mark. That's a departure from most projects pitched on the site, which are pretty small-time—a cartoonist looking for $2,000 to publish a book or a band that needs to rent studio time.

In January, first-time director Jocelyn Towne, an actor in Los Angeles, raised $111,965, based largely on the strength of a clever 4-minute pitch for her film *I Am I*, a drama about a woman and her long-lost father. "When I first pressed the button to get this all started, I was like, who knows?" says Towne. "It was a complete shock, especially since we personally knew only about 20 percent of our contributors." Strickler says backers tend to come from the extended network of friends of friends, but there are some 85,000 repeat contributors on the site.

Katie Aselton and her husband, Mark Duplass, are currently raising $20,000 to rent a state-of-the-art **Arri Alexa** digital camera to shoot Aselton's next film, *Black Rock*. The two are not rookies. Aselton directed *The Freebie*; Duplass, with his brother, Jay, made *Cyrus*, a comedy starring John C. Reilly, Jonah Hill, and Marisa Tomei. *Black Rock*, a thriller set in Maine, will star Kate Bosworth of *Superman Returns*. Aselton and Duplass are funding the movie out of their own pockets. Aselton says that as soon as they considered using the Alexa, which can shoot in almost any light, "we thought maybe we'll just go to Kickstarter" to pay for it. For a pledge of $500 or more, Aselton will send you two Maine lobsters and call to advise you while you cook them.

Independence is one of Kickstarter's main advantages over the typical filmmaker fundraising road show. "You're meeting tycoons and people's weird uncles," says Strickler. "And along with that comes significant strings. Maybe they want to cast their daughter in the second lead." Aselton says she and Duplass could have gone the studio or private-equity route to fund *Black Rock*, but "that also means getting a lot of cooks in your kitchen." Plus, the site is a way to promote a movie ahead of time. "It's created a fan base for the film, and it hasn't even been made yet," says Towne of *I Am I*. Marian Koltai-Levine, head of film marketing and distribution at the public-relations firm PMK*BNC, agrees that "it's become a viable marketing resource." She used Kickstarter in late 2009 to raise $5,250 to help send the crew of the indie comedy *Bass Ackwards* to the Sundance Film Festival.

As for *Blue Like Jazz*, it raced past its $125,000 goal and raised a Kickstarter film record of $345,992 last October. Taylor's backer in Seattle, seeing the interest, matched that sum and tacked on a little more. Taylor shot the movie for $750,000 and, thanks to new investors who have come on board, has $500,000 remaining for post-production. The first test screening is scheduled for June in Portland. In the meantime, Taylor has thousands of phone calls to make. "I just didn't think this was going to work," he says, "so I said for anyone who gave $10 or more, I would call them and thank them personally." He's about halfway through a notebook of 3,300 names. **B**

—*Ira Boudway*

The bottom line *Indie filmmakers say Kickstarter helps them finance and promote movies with less interference from studios and investors.*

Two veterans of indie cinema are using Kickstarter to raise ...

$20,000

... to cover the rental costs of a high-end Arri Alexa digital camera for use on their new thriller, *Black Rock*



ILLUSTRATION BY JUSTIN METZ


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READY, AIM, HIRE

THE NATION'S SERVICE VETERANS SHOULDN'T BE AMONG THE TOP RANKS OF THE UNEMPLOYED, BUT THEY ARE. SOME CORPORATIONS AND THE GOVERNMENT ARE OUT TO CHANGE THAT

Along with their families, the 3 million American men and women in military service, either active or reserve, bear the brunt of the sacrifices demanded by the wars in Iraq and Afghanistan. Sadly, according to the U.S. Department of Labor (DOL), the unemployment rate for new veterans is 12.5 percent, far above the current national average of about 9 percent, and there are more than 1 million unemployed veterans of the U.S. Armed Forces. "Veterans 20 to 24 are the cohort with the highest rate of unemployment," said Raymond M. Jefferson, Assistant Secretary for the Veterans' Employment & Training Service (VETS), an agency of the DOL, during testimony in April to the Senate Committee on Veterans Affairs. These young men and women deserve better from U.S. employers—and, ironically, they're often exactly the type of skilled, dedicated employees that both large corporations and small businesses are seeking.

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THE WAY FORWARD
JPMorgan Chase & Co.



HELPING OUR TROOPS FIND JOBS AT HOME.

At JPMorgan Chase, we are grateful to the men and women who defend our nation. Recently, we announced new homeownership initiatives for servicemembers and veterans. We're also helping in the area of employment.

We have formed an alliance with ten major corporate employers to commit to hiring at least 100,000 veterans by 2020. We believe that there is no better experience than military service when it comes to developing the skills and character that employers are looking for. And we expect more employers to join the alliance as we go forward.

We are proud to help our nation's troops make the transition back home. This is how JPMorgan Chase continues to make a difference.

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Servicemembers can call 877-469-0110 for dedicated assistance from Chase

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WHAT VETERANS BRING TO COMPANIES

"The skills that veterans bring were forged in the most difficult of situations; they're literally battle-tested," says Nate Herman, the chief administrative officer for military and veterans affairs for JPMorgan Chase. "In my opinion, no other population brings the work ethic, commitment, value set and experiences that veterans can bring to the corporate table."

"Veterans understand the volatility that exists in the world today, as well as the importance of motivating others in difficult circumstances," says Bob McDonald, chairman, president and CEO of Procter & Gamble.

To help veterans start productive careers, the VETS office recently rolled out an arsenal of strengthened programs. One of the cornerstone offerings is a revamped transition assistance program (TAP), which it is hoped will kick off on Veterans Day.

"[TAP] is a comprehensive two-and-a-half-day program that prepares service members to be peak performers in private-sector companies," Jefferson testified. "Our goal is to provide TAP at every location requested by the Armed Services or National Guard and Reserve components." TAP teaches veterans fundamentals in life and career planning: communicating their value to employers, developing a network, transitioning to a civilian work environment and being entrepreneurial, among many other skills.

VETS has also piloted an accelerated certificate program with the DOL's Job Corps—the free job training program instituted in the 1960s. While American veterans always get priority in Job Corps programs, the new pilot program provides eight to 24 months of job training in more than 50 fields to veterans aged 20–24, at no cost to them. After graduation, career counselors will work with vets for up to 21 months to help them find jobs. "Job Corps graduates have the opportunity to earn an industry-recognized certification or credential that supports the skills and knowledge gained through career training," testified Jefferson.

> **"VETERANS ARE NOT AFRAID TO MAKE DIFFICULT DECISIONS. THAT IS MEANINGFUL IN THE WORKPLACE."**
>
> **– JAY SIEMBIEDA**

HOW CORPORATIONS ARE HELPING

"The employment of veterans is a pressing public issue, and we clearly have a societal obligation to this population," says Herman, who is a member of the Marine Corps and a combat veteran himself. "At JPMorgan Chase, we have a whole team that's devoted to military and veterans' affairs. And I'm proud to say that we're hiring veterans at a rate of about 20 per day."

To increase the impact of their hiring efforts, JPMorgan Chase launched the "100,000 Jobs Mission" with 10 other partner companies in March. The goal of this consortium is to hire a minimum of 100,000 veterans by 2020. "Since starting this program, we've hired more than 700 veterans at JPMorgan Chase alone, adding to the thousands of veterans and military spouses who are already among our nearly 243,000 employees worldwide," says Herman. "The 100,000 goal is a floor but not a ceiling. As we grow the number of partners, we'll increase that target number."

With all the qualities that veterans bring to the organization, a large-scale hiring initiative is also a sound, strategic investment for JPMorgan Chase. "It's a win-win situation, but I would argue that we get the better end of the deal," says Herman.

Building a consortium with other major global companies will help veterans find positions even if they're not a fit for one of the employers, says Herman. "The partner companies will share these résumés and other data. If a veteran is not a good fit for JPMorgan Chase, we can recommend him or her to another firm. Every military applicant receives a return call and gets feedback from one of our recruiters, whether hired or not."

SMOOTHING THE TRANSITION

Siemens Corp. is another global employer that has announced a commitment to hire American veterans. "With more than 3,000

SAVVY VETERANS



JAY SIEMBIEDA
JPMORGAN CHASE

After nine years of active duty, including flying search and rescue with the Navy, and three years at the White House Military Office, Siembieda, an Annapolis grad, earned an MBA from Yale. Today, he manages a team of seven analysts. "My role is to be the relationship manager with high net worth clients, and to work among groups internally to deliver what clients need," says Siembieda.



JIM JONES
SIEMENS

After retiring from a career in the Air Force in 2001, Jim Jones joined Siemens as a quality assurance superintendent. "He had experience with non-destructive examinations [NDEs] in the power generation industry, and became a plant manager in April 2007, where he had 1.5 million hours of no-loss-time accidents," says the CEO of Siemens, Eric Spiegel. "His plant was written up in several venues for this safety record. He was promoted to director of all of our wind-turbine blade manufacturing facilities last month. Jim is currently located in Fort Madison, Iowa. He's one of the stellar employees who has made all the difference at Siemens."

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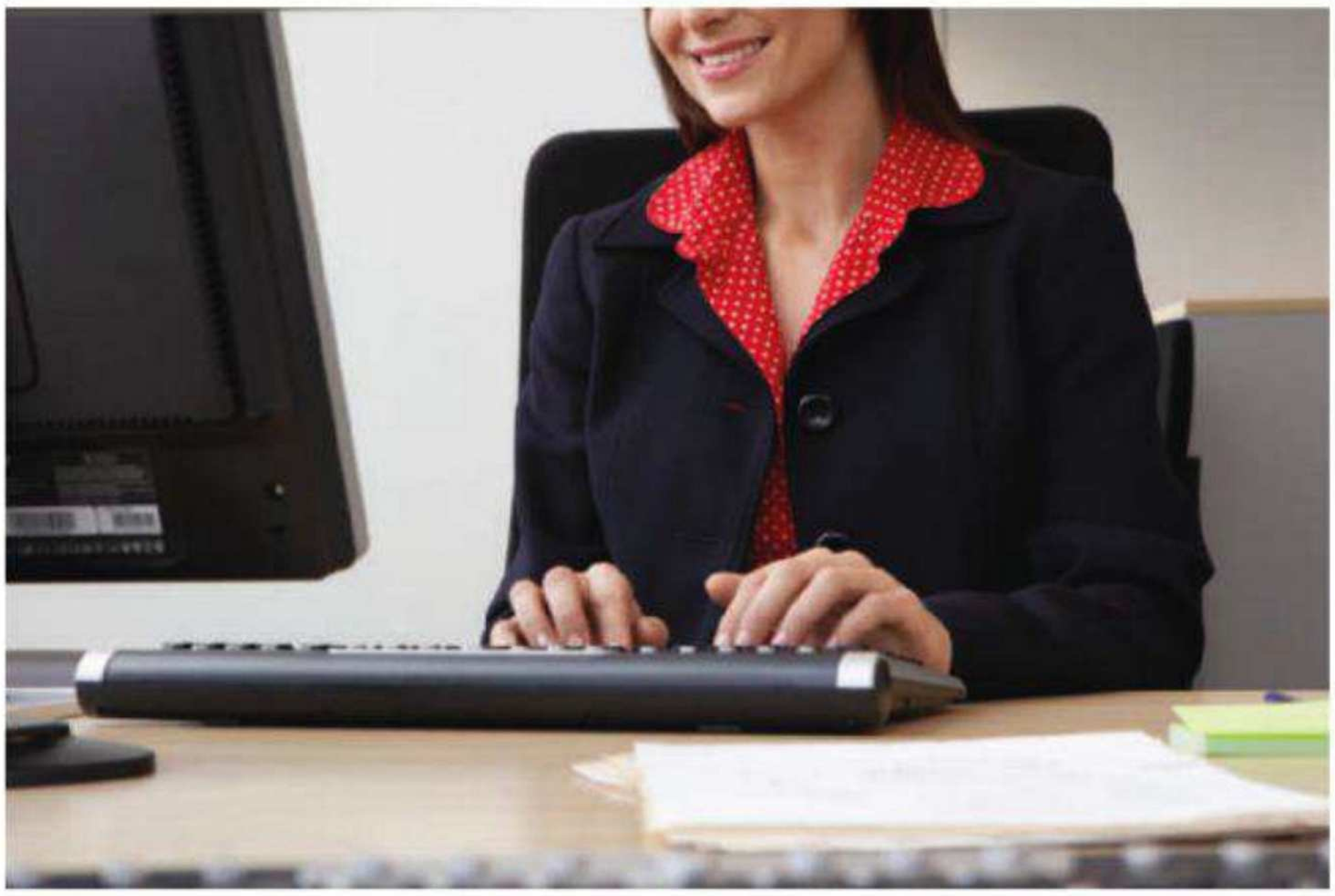
Answering our nation's toughest challenges takes teamwork. At Siemens, we help strengthen America's security, power its cities and care for its patients. And we're counting on leaders with the technical skills, character, courage and fortitude it takes to triumph over any challenge. Qualities which America's military veterans have in abundance.

This year, Siemens is reserving 10 percent of all open positions in our clean-technology industries exclusively for veterans. We are also developing a comprehensive job training program designed specifically to help these heroes transition smoothly back into the workforce.

Somewhere in America, our team of more than 60,000 employees spends every day creating answers that will last for years to come.

siemens.com/answers

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Offering services to members of the military and their families has long made it vitally important for Health Net to have former servicemen and women on its staff. "Early on, we quickly realized how important it was to have knowledgeable people with a military background on our team, for their perspective. They can better relate to the person on the other end of the phone."

Tough estimates close to 25 percent of Health Net's employees have either served in the military or are spouses of service members. "Having individuals who are well rounded and service-minded—and trained to operate under life-threatening circumstances—can benefit any organization," says Tough. "I implore all business leaders to hire veterans or retired military personnel, especially on their management team."

"HIRING OUR HEROES" MEGA-HIRING FAIRS WILL TYPICALLY CONNECT OVER 100 COMPANIES WITH MORE THAN 1,000 VETERANS.

open positions in the U.S. alone, Siemens is actively seeking to hire the best and the brightest for positions around the country. Our servicemen and women possess unique skill sets and training that make them outstanding employees," says Eric Spiegel, president and CEO of Siemens.

Specifically, Siemens will reserve 10 percent of those positions in their clean-tech industries for veterans. "By putting a hard number on the table, we're committing ourselves to a goal that's transparent and measurable, and one that we're publicly committed to achieving," says Spiegel. "Having these brave and talented young men and women join our team will make our company stronger for years to come, and we are incredibly fortunate to have them."

According to Spiegel, "Siemens is also committed to making sure the transition from the Armed Services to the private sector is as smooth as possible for these incoming employees." To help this effort, the Siemens Veterans Network was launched in the summer of 2010. "It's our company's first employee resource group with a national footprint," explains Spiegel. Many among this group of more than 275 Siemens employees are former military members whose community service to support veterans and active-duty military families includes a mentorship program through American Corporate Partners. Internally at Siemens, the network members also mentor veterans who are transitioning from the military to corporate America.

Keeping veterans and their families healthy is the business of Steven D. Tough, president of Health Net's Government and Specialty division, which includes Health Net Federal Services, a managed-care organization that delivers health-care services to more than 3 million men and women in uniformed services through TRICARE, the U.S. military health-care program for active-duty and retired military personnel.

"We've been in the business of supporting military personnel and families for more than 23 years," says Tough. "We were selected as the original contractor in 1988 for the precursor to the TRICARE program. We pride ourselves in serving the veteran population and delivering the services they deserve and expect. We try to do so with the highest level of commitment, and we're extremely proud to have the opportunity to serve those who have served on our behalf."

HOW TO HIRE A VETERAN

Many companies want to hire veterans but don't know where to find them. That's one reason VETS is partnering with the U.S. Chamber of Commerce in the national "Hiring Our Heroes" campaign. One of the pillars of "Hiring Our Heroes" is an initiative by the U.S. Chamber and VETS to host 100 "Mega-Hiring Fairs" in communities across the country in 2011–2012. The kickoff fair was held on March 24 in Chicago, and was a major success with 127 employers and over 1,200 veterans and military spouses participating.

"These Mega-Hiring Fairs will typically connect over 100 companies with more than 1,000 veterans looking for jobs. NBC has covered the first few hiring fairs and may cover many more through their 200-plus affiliate stations," says Kevin Schmiegel, vice president of the U.S. Chamber's veterans employment program. "Mega-Hiring Fairs offer an opportunity for every CEO or business leader to say to their HR executive, 'I want us represented at each of those hiring fairs, with jobs available to hire veterans.'"

Finally, any HR exec or business leader can reach out to VETS representatives to find veterans who are qualified for positions at dol.gov/vets, which provides contact information for all 50 state directors and 2,000 employment representatives who serve as conduits to the entire veterans employment community. ●

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THE END OF MAIL

The U.S. Postal Service is as old as the country, delivers 40 percent of the world's mail, and is on the verge of collapse. It doesn't have to be. By Devin Leonard

Phillip Herr looks like many of the men who toil deep within the federal government. He wears blue suits. He keeps his graying hair and mustache neatly trimmed. He has an inoffensively earnest manner. He also has heavy bags under his eyes, which testify to the long hours he spends scrutinizing federal spending for the U.S. Government Accountability Office, the congressional watchdog agency where he is Director of Physical Infrastructure Issues. As his title suggests, Herr devotes much of his time to highway programs. But for the past three years he has been diagnosing what ails the U.S. Postal Service.

It's a lonely calling. "Washington is full of Carnegie and Brookings Institutes with people who can tell you every option we have in Egypt or Pakistan," laments Herr, who has a PhD in anthropology from Columbia University. "Try and find someone who does that on the postal service. There aren't many."

Yet Herr finds the USPS fascinating: ubiquitous, relied on, and headed off a cliff. Its trucks are everywhere; few give it a second thought. "It's one of those things that the public just takes for granted," he says. "The mailman shows up, drops off the mail, and that's it."

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He is struck by how many USPS executives started out as letter carriers or clerks. He finds them so consumed with delivering mail that they have been slow to grasp how swiftly the service's financial condition is deteriorating. "We said, 'What's your 10-year plan?'" Herr recalls. "They didn't have one."

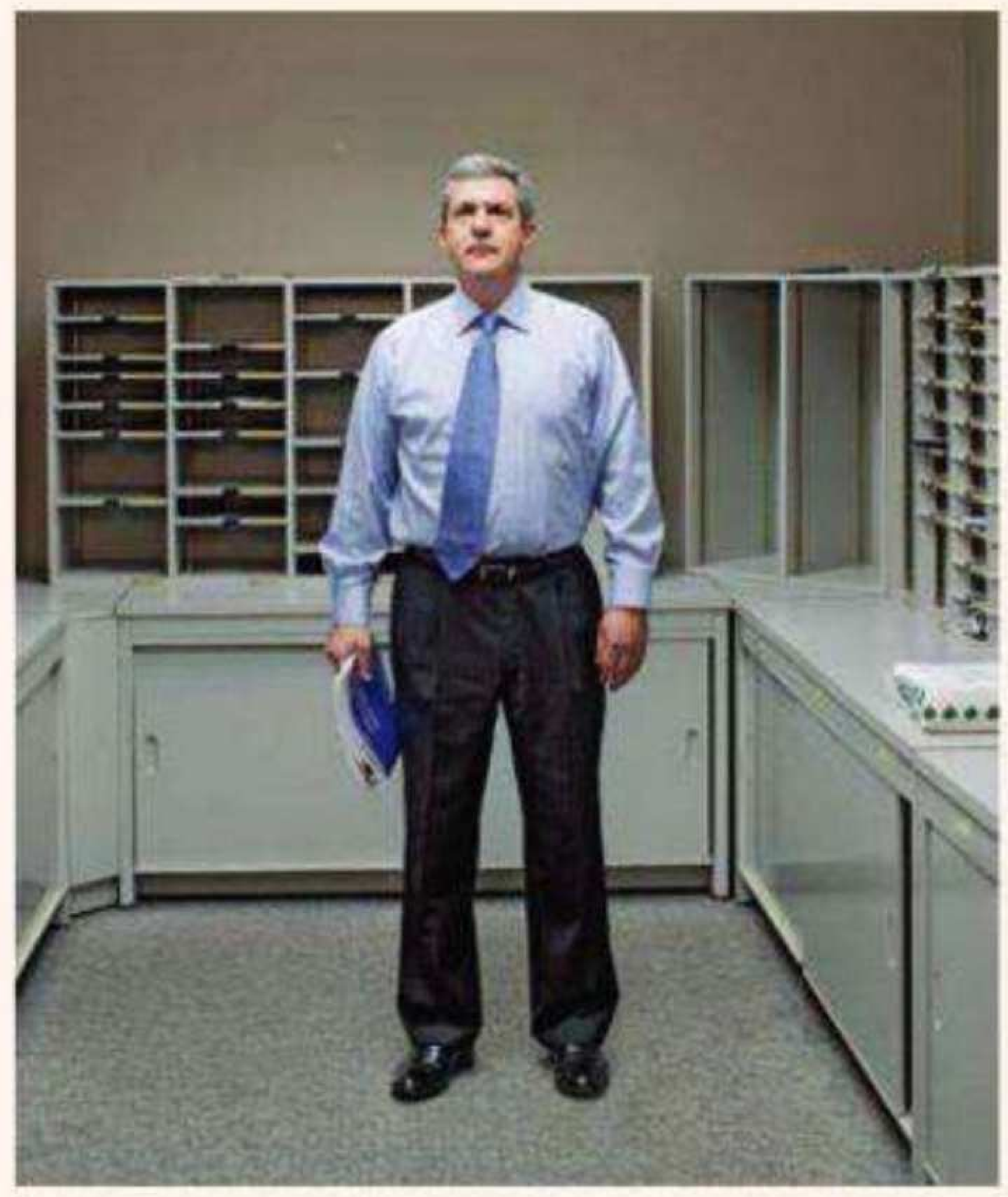
Congress gave him until the end of 2011 to report on the USPS's woes. But Herr and his team concluded that the postal service's business model was so badly broken that collapse was imminent. Abandoning a long tradition of overdue reports, they felt they had to deliver theirs 18 months early in April 2010 to the various House and Senate committees and subcommittees that watch over the USPS. A year later, the situation is even grimmer. With the rise of e-mail and the decline of letters, mail volume is falling at a staggering rate, and the postal service's survival plan isn't reassuring. Elsewhere in the world, postal services are grappling with the same dilemma—only most of them, in humbling contrast, are thriving.

The USPS is a wondrous American creation. Six days a week it delivers an average of 563 million pieces of mail—40 percent of the entire world's volume. For the price of a 44¢ stamp, you can mail a letter anywhere within the nation's borders. The service will carry it by pack mule to the Havasupai Indian reservation at the bottom of the Grand Canyon. Mailmen on snowmobiles take it to the wilds of Alaska. If your recipient can no longer be found, the USPS will return it at no extra charge. It may be the greatest bargain on earth.

It takes an enormous organization to carry out such a mission. The USPS has 571,566 full-time workers, making it the country's second-largest civilian employer after Wal-Mart Stores. It has 31,871 post offices, more than the combined domestic retail outlets of Wal-Mart, Starbucks, and McDonald's. Last year its revenues were $67 billion, and its expenses were even greater. Postal service executives proudly note that if it were a private company, it would be No. 29 on the Fortune 500.

The problems of the USPS are just as big. It relies on first-class mail to fund most of its operations, but first-class mail volume is steadily declining—in 2005 it fell below junk mail for the first time. This was a significant milestone. The USPS needs three pieces of junk mail to replace the profit of a vanished stamp-bearing letter.

During the real estate boom, a surge in junk mail papered over the unraveling of the postal service's longtime business



Herr advocates closing post offices and creating digital services

plan. Banks flooded mailboxes with subprime mortgage offers and credit-card come-ons. Then came the recession. Total mail volume plunged 20 percent from 2006 to 2010.

Since 2007 the USPS has been unable to cover its annual budget, 80 percent of which goes to salaries and benefits. In contrast, 43 percent of FedEx's budget and 61 percent of United Parcel Service's pay go to employee-related expenses. Perhaps it's not surprising that the postal service's two primary rivals are more nimble. According to SJ Consulting Group, the USPS has more than a 15 percent share of the American express and ground-shipping market. FedEx has 32 percent, UPS 53 percent.

The USPS has stayed afloat by borrowing $12 billion from the U.S. Treasury. This year it will reach its statutory debt limit. After that, insolvency looms.

On Mar. 2, Postmaster General Patrick R. Donahoe warned Congress that his agency would default on $5.5 billion of health-care costs set aside for its future retirees scheduled for payment on Sept. 30 unless the government comes to the rescue. "At the end of the year, we are out of cash," Donahoe said. He noted that the unusual requirement was enacted five years ago by Congress before mail started to disappear.

This should be a moment for the country to ask some basic questions about its mail delivery system. Does it make sense for the postal service to charge the same amount to take a letter to Alaska that it does to carry it three city blocks? Should the USPS operate the world's largest network of post offices when 80 percent of them lose money? And is there a way for the country to have a mail system that addresses the needs of consumers who use the Internet to correspond?

The Capitol Hill debate is primarily about money. The USPS and its employee unions are lobbying for the least painful remedy: They want the agency to be relieved of its requirement to build a health-care trust fund for its future retirees. They are supported by junk mailers, greeting card manufacturers, and magazine publishers whose businesses are, in some cases, subsidized by the post office's generously low mailing prices. Never mind that their benefactor loses money on some of their products, most notably magazines and some junk mail.

Democrats receive the vast majority of the contributions made by postal workers' unions, according to campaign finance records, so they tend to be sympathetic. President Barack Obama inserted a proposal in his 2012 budget to absolve the USPS of $4 billion of its retiree health-care liabilities in 2011. This would enable it to slog through another year without extraordinary changes. Meanwhile, Senator Thomas Carper (D-Del.) introduced a bill on May 17 that would relieve the USPS of its prefunding headaches. "If we do nothing, we face a future without the valuable services that the postal service provides," Carper cautioned in a statement the same day. The bill would give the postal service access to as much as $75 billion it claims to have overpaid the federal retirement system. Naturally, the USPS and its unions are pushing for this because it would swiftly erase the agency's red ink. Others in Washington dispute the postal service's claim and call this wishful thinking at a time when there is such concern about the rising deficit. They also add that the bill would do nothing to address the larger issues afflicting the USPS.

House Republicans are less charitable. They oppose anything that could be construed as a bailout. They are pushing instead for the USPS to make deep budget cuts. Even so, budget hawks sound nervous. In a March hearing, the often provocative U.S. Representative Darrell Issa (R-Calif.) said two post offices could be closed in every congressional district. He added with a laugh: "Let's hope there's not one—or three—in mine." (A spokesman for Issa says that the congressman was trying to "introduce a bit of levity" into the proceeding and is fully in favor of shuttering postal facilities.)

The irony of the political stalemate

PHOTOGRAPHS BY OFER WOLBERGER FOR BLOOMBERG BUSINESSWEEK

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Donahoe says cutting delivery to five days a week could save $3 billion annually

is that it may be much simpler to fix the USPS than more intractably troubled federal programs such as Medicare and Social Security. Indeed, many other countries have figured out profitable ways to run a postal service. The U.S. could learn a lot from them. Yet hardly anybody is talking about this, except for Herr.

It's a sunny afternoon in early March, and Patrick Donahoe is talking about music. "Are you a fan of the Allman Brothers?" he asks. "They used to sing that song *One Way Out*. There's a way out."

The 73rd Postmaster General sits comfortably in a blue leather chair in his wood-paneled Washington office, surrounded by postal artifacts. There's a portrait of original Postmaster Benjamin Franklin on loan from the Smithsonian Institution and a bronze statue of a Pony Express rider. Donahoe, a car buff, has also decorated the room with sports car stamps.

A broad-shouldered 55-year-old from Pittsburgh, he looks like he could easily deliver a heavy sack of mail. He has toted plenty in his time. He started as a clerk in his hometown mail sorting center when he was in college. "I just never left," Donahoe chuckles. "That's the story of a lot of people around here."

Donahoe, who took office in January, is surprisingly upbeat for someone in charge of an agency on the verge of bankruptcy. He says he wants to dispel "some of the negative vibes that have been floating around" the postal service. He acknowledges that first-class mail is in an inexorable decline, but he sees junk mail rebounding with the economy. In the last quarter of 2010, junk revenue climbed 7.1 percent. "That proves that there is viability in our system," Donahoe insists. (Unfortunately for the USPS, junk volume has since plateaued.)

The Postmaster General promises that if the USPS is excused from its annual health-care prepayment, he will wring enough costs out of the system to turn a profit on its remaining mail stream. He wants permission from Congress to cut weekly delivery from six to five days, which he says will save $3 billion a year. He says he wants to reduce the USPS's headcount by 20 percent over the next five years through attrition, though the agency's union contracts prohibit layoffs.

What's more, Donahoe wants to close post offices and move some of their operations into convenience stores and supermarkets, where nonunion workers can staff them. The USPS is targeting 2,000 of its 31,871 post offices. That's not much for an agency that's nearly $15 billion in debt. Donahoe says he's doing what he can, despite a federal stricture that forbids the closing of post offices solely for economic reasons. He tells anybody who will listen on Capitol Hill that the prohibition makes little sense at a time when his agency's coffers are nearly depleted.

Some praise Donahoe for his early efforts. "I'm really high on the guy," says Anthony W. Conway, executive director of the Alliance of Non-Profit Mailers, a coalition of colleges, fraternal organizations, and advocacy groups that use the mail for fundraising. "Pat," he says, "is a breath of fresh air."

The USPS has historically placed the interests of its unions first. That hasn't changed. In March it reached a four-and-a-half-year agreement with the 250,000-member American Postal Workers Union, which represents mail clerks, drivers, mechanics, and custodians. The pact extends the no-layoff provision and provides a 3.5 percent raise for APWU members over the period of the contract, along with seven upcapped cost-of-living increases. The union is happy. "Despite the fact that the postal service is on the edge of insolvency, the union and management have reached an agreement that is a 'win-win' proposition," said APWU President Cliff Guffey on the union's website. A USPS spokeswoman said the agency agreed to the raise because it feared the decision would otherwise be made by an arbitrator who might be even more deferential to the union.

Congressional Republicans say the agreement sets a bad precedent for the USPS's other three unions, whose contracts expire this year. Fredric V. Rolando, president of the 275,000-member National Association of Letter Carriers, doesn't sound like he's interested in making major concessions. He argues the agency should be increasing rather than cutting its services. One of his ideas is to outfit postal trucks with sensors so mail carriers can thwart possible biological terrorist attacks. "They can work with Homeland Security to detect things that are in the air," Rolando says. The Homeland Security Dept. declined to comment.

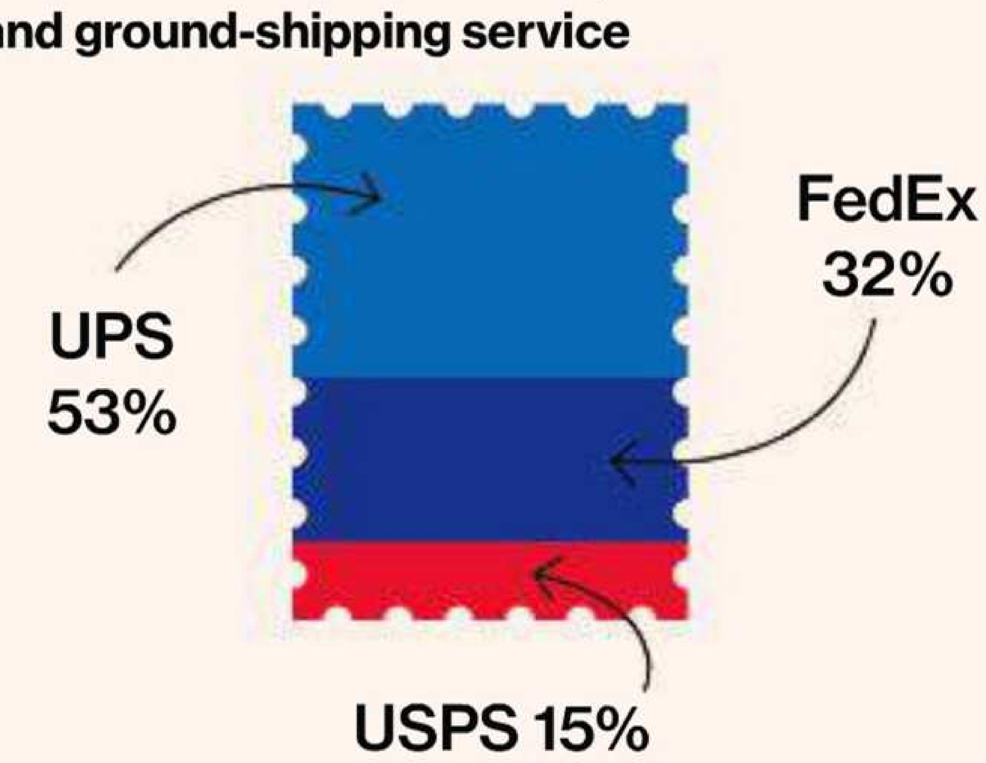
The more Phillip Herr tried to figure out the USPS and its financial agonies last year, the more he was vexed by something: He couldn't say for sure how poorly it was doing because he had nothing to contrast it with. "There is always the 'compared to what?' question," Herr says. "Compared to FedEx? Compared to UPS?"

Herr thought it made more sense to compare the USPS to postal services in other countries. Last summer he sent a small team of analysts to Finland, Sweden, Germany, Switzerland, Austria, and Canada. He was fascinated by what they discovered.

Three decades ago, most postal services around the developed world were government-run monopolies like the USPS. In the late '80s, the European Union set out to create a single postal market. It prodded members to give up their monopolies and compete with one another. The effort roused an industry often thought to be sleepy and backward-looking.

Many countries closed as many of their brick-and-mortar post offices as possible, moving these services into gas stations and convenience stores, which then take them over—just as the USPS is trying to do now, only far more aggressively. Today, Sweden's Posten runs only 12 percent of its post offices. The rest are

Share of 2010 American express and ground-shipping service



DATA: SJ CONSULTING GROUP

The postman's profit margins for the first three months in 2011



26.15%	4.89%	3.6%	–13.58%
SingPost	Deutsche Post DHL	PostNord	USPS

DATA: COMPANY AND GOVERNMENT REPORTS

in the hands of third parties. Deutsche Post is now a private company and runs just 2 percent of the post offices in Germany. In contrast, the USPS operates all of its post offices.

Some of these newly energized mail services used the savings to pursue new business lines. Deutsche Post bought DHL, a package deliverer that competes with FedEx and UPS. "More than half of our workforce is outside of Germany," says Markus Reckling, executive vice-president for corporate development at Deutsche Post. "It's pretty much the same thing for our profits."

Many used their extra cash to create digital mail products that allow customers to send and receive letters from their computers. Itella, the Finnish postal service, keeps a digital archive of its users' mail for seven years and helps them pay bills online securely. Swiss Post lets customers choose if they want their mail delivered at home in hard copy or scanned and sent to their preferred Internet-connected device. Customers can also tell Swiss Post if they would rather not receive items such as junk mail.

Sweden's Posten has an app that lets customers turn digital photos on their mobile phones into postcards. It is unveiling a service that will allow cell-phone users to send letters without stamps. Posten will text them a numerical code that they can jot down on envelopes in place of a stamp for a yet-to-be-determined charge.

Anders Asberg, Posten's head of marketing and development, says the service is experimenting with these initiatives, and he expects some will prove to be lucrative. "The customers are all on these digital interfaces now," he says. "That's where the growth is going to be in the future."

Posten can afford to take chances. In 2009 the Swedish mail carrier merged with Post Danmark, the Danish postal service, creating PostNord, a company with $6.2 billion in net sales and $320 million in EBITDA. In 2010 the latter rose by 43 percent, to $490 million.

"The question is, are there any special circumstances that suggest all these other countries are wrong and we are right?" says James I. Campbell Jr., a consultant in Potomac, Md., who advises foreign governments on postal policy issues. "The answer is pretty simple: The European countries are on a reasonably viable course. The U.S. is not."

Herr traveled to Sweden, Switzerland, and Finland last summer. He met with Posten executives who told him how hard they had worked to sell their plans to close post offices to a skeptical public. Not everyone approved. Some Swedes were very upset. Eventually, they got over it. In the end, they got their mail as efficiently and reliably as before.

In Switzerland, Herr met with Swiss Post executives who demonstrated the digital mail service. "You can say, 'Here's what I want,'" he explains. "'No, thank you, I'd rather not have that seed catalogue. But I would like to have my bill from Citibank and my mortgage.' Well, maybe the advertising mail people wouldn't be too excited about that."

Herr returned to America full of excitement. In February he delivered a 40-page report to the House subcommittee that oversees the postal service. It makes two major points: The USPS needs to close post offices, as many foreign postal services have done despite real opposition. And the USPS needs to create products for its wired customers if it wants to play a role in the future of communication. He acknowledges some foreign digital services are in early stages, but they are in demand, and in some cases the digital technology reduces delivery costs.

Joseph Corbett, the American postal service's chief financial officer, thanked Herr for his efforts. At the same time, he said the agency was sticking to its plan. Postmaster Donahoe says he isn't so sure about the digital mail initiatives emerging outside the U.S. "The value added there might not be as much as everybody thinks," he says. Joanne Veto, a USPS spokeswoman, said in an e-mail that the USPS had hired outside consultants who examined some of these digital mail offerings and advised the agency not to pursue them: "While foreign posts did make money by diversifying their products, it took as many as 20 years before a profit was realized. In the short term, there was limited or no profit. We do not have 20 years."

Under Donahoe, the USPS is focused instead on trying to slow the migration of its customers to the Net. The man in charge of this task, which brings to mind King Canute's attempts to hold back the incoming tide, is Paul Vogel, a former letter carrier who is now the postal service's chief marketing sales officer. He is less spirited than his boss and understandably so; his job is to persuade banks to keep sending paper statements in the mail. It's a losing battle, and Vogel knows it. "Inevitably, it's going to go to those new technologies," he sighs.

Herr couldn't agree more. The other day he got a notice in the mail from the U.S. Senate Federal Credit Union. It said it was going paperless in August. Customers who still want to get their statements mailed to them would have to pay a fee. He dropped by the office on Capitol Hill to find out how much. "I have a disproportionate interest in things like this, given the work I've been doing lately," Herr says.

A credit union worker told him the fee was $5 a month. Herr was astonished. "I thought to myself, that's $60 a year," he recalls. "Who's going to want to do that? What happens when Bank of America or Citigroup says you are going to have to pay to get your statement on paper? That's going to change a lot of behavior. It's going to affect the postal service. That's how they make most of their money."

The baying begins as soon as Jim Rice climbs out of his truck with his mail sack on his shoulder. He looks around warily. "This is the street where I've had some issues with dogs," he says.

It's a pleasant morning in early April, and Rice, a 58-year-old letter carrier, is going from house to house on Rugby Road in Cardinal Valley, a blue-collar neighborhood in Lexington, Ky. He hardly appears a threat in his white pith helmet and ill-fitting blue uniform. The pets on his route have a different view. Rice has fought off Piper, a black Labrador retriever. He recently used his mail pouch to fend off Rocky, a German shepherd.

The Kentucky letter carrier is stoic about his scrapes. Some things about his

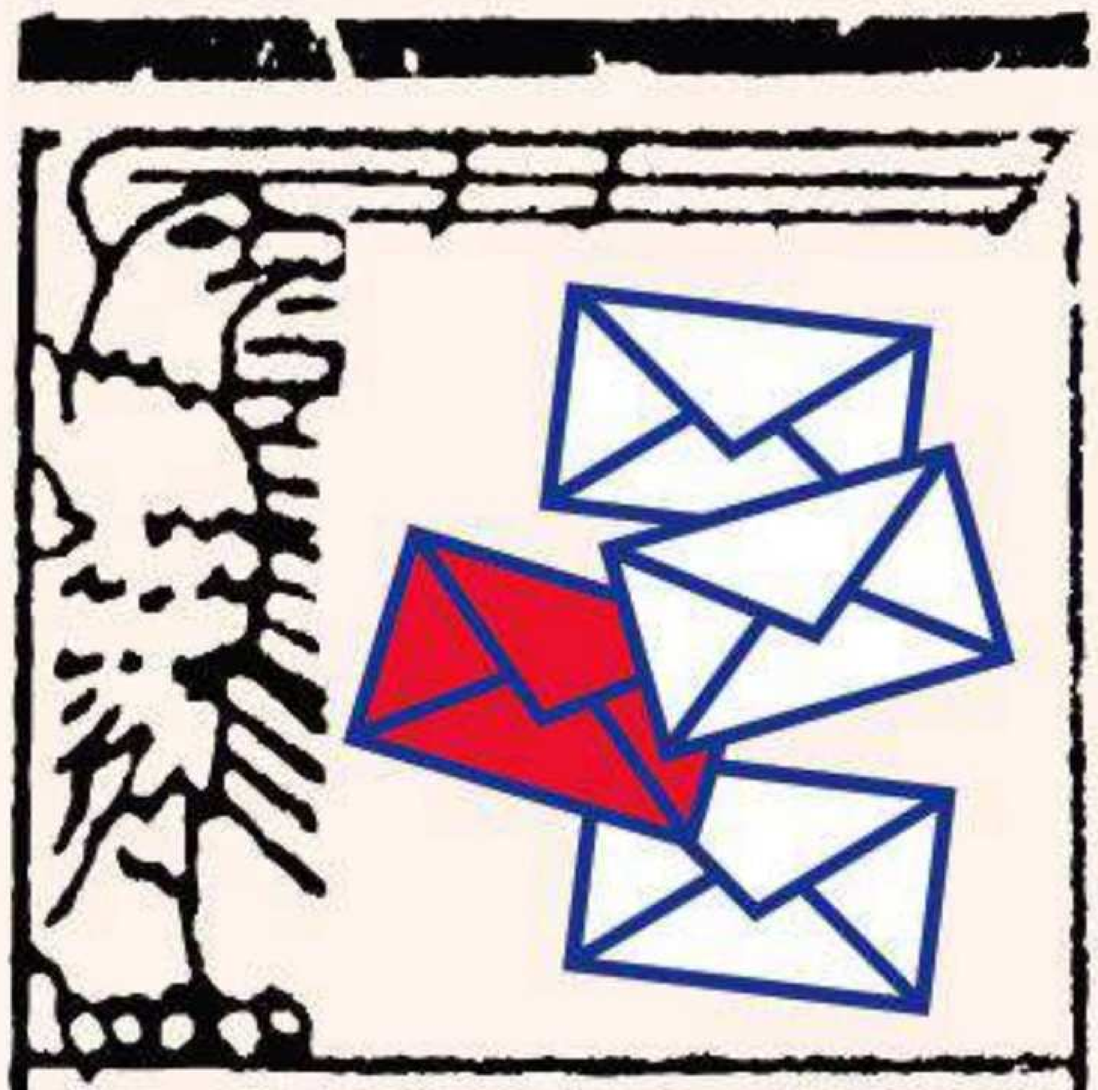
job are eternal. Others are changing rapidly. He carries a lot more of what he calls "standard mail." "Civilians call it junk mail," Rice says, joking. "We don't like that term. We call it job security."

Rice's ritual hand delivery of the mail remains the essence of the USPS's business. Until fairly recently, this was a fabulous model, although its history of success, in retrospect, is notable for its missed opportunities.

As America's population expanded, so did the postal service. In its early years, people paid to receive mail. In 1863 the U.S. Post Office Dept., a Cabinet level agency, was flush enough to begin offering free city delivery. In 1896 it expanded free service to rural areas, providing what it now refers to as "universal service" to all Americans. Mail volume exploded. In cities such as Philadelphia and Boston, letter carriers made their appointed rounds three times a day.

Inevitably, perhaps, there were problems. The post office became a patronage dumping ground. After decades of mismanagement and neglect, service broke down completely in Chicago in 1966. "The sorting floors were bursting with more than 5 million letters, parcels, circulars, and magazines that could not be processed," Lawrence O'Brien, the Postmaster General at the time, would recall somewhat poetically. "Outbound mail sacks formed still gray mountain ranges as they waited to be shipped out."

Four years later, President Richard M. Nixon signed the Postal Reorganization Act, transforming the Post Office Dept. into the U.S. Postal Service, a government corporation that was supposed to pay for itself and behave more like a private business. This proved a naive assumption. The USPS's leaders rewarded their union employees with more expensive benefits than most federal employees enjoy. According to the U.S. Postal Service Inspector General's Office, it covers 79 percent of most of its employees' health benefits, compared with the typical 72 percent for federal workers.



First-class mail is three times as profitable as junk mail

DATA: GAO

The USPS was slow to react to shifts in the industry. In the late '70s, Congress prodded it to allow private companies to carry letters needing urgent delivery. FedEx and UPS built enormously valuable businesses on the USPS's turf. They weren't required to visit every doorstep in the country on a daily basis. They set their own rates and had no qualms about extracting concessions from their unions. The postal service tried to compete, without much success. "They just cleaned the postal service's clock," says Tad DeHaven, a budget analyst at the Cato Institute, a libertarian think tank in Washington. It didn't matter at the time. The agency had its slower-moving letter monopoly, and mail volume kept climbing.

The USPS slumbered as the postal service industry was upended overseas. Michael Coughlin, former Deputy Postmaster General, attended meetings in Brussels in the early 1990s where his peers in Sweden and Germany described the innovative things they were doing. "I would sit there and think, I wish that was us," he says. Coughlin left the USPS in 1999 to work at Accenture, a global consulting firm, where he advised foreign postal services on their streamlining efforts. He retired in 2009.

In the late '90s, there was talk within the USPS about reforms, including privatizing the organization. Robert Reisner, a former USPS vice-president of strategic planning, recalls raising some of these issues during a visit to the White House with a Clinton Administration official: "She said, 'Well, we would have to ask our union friends. You know they are critical to the coming campaign.' "

At the same time, e-mail took hold. By 2000 the USPS was losing money. The GAO warned that the service might not be able to cover its retiree health-care costs.

Congress came up with what it thought would be a fix. In 2006 it relieved the postal service of $27 billion in pension liabilities for workers with military service. At the same time, the USPS agreed to make annual payments of $5.5 billion for the next 10 years to build up a fund for future retirees. John E. Potter, the Postmaster General at the time, was ecstatic when the bill was signed into law. "We're planning for the future right now," he said. "Today the postal service is operating in the black."

The USPS was O.K. that year. Then, over the next three years, the economy collapsed, and the service lost $12 billion.

A former letter carrier in the Bronx, Potter remained ebullient. He testified before Congress in 2009 that mail volume would eventually return. Herr sat nearby. He says he was stunned. Potter announced his resignation six months after Herr issued his report on the USPS's broken business model. The postal service rushed out a study of its own around the same time by McKinsey that reached the same dispiriting conclusions.

The USPS, however, still seems to be in denial. "The postal service is already carrying more junk than first class," says postal consultant Campbell. "Pretty soon it's going to be a government-run advertising mail delivery service. Does that make any sense? It doesn't make any sense."

There are still flaws in the USPS's junk-centric plan. The service now predicts that total mail volume will decline from 171 billion pieces annually in 2010 to 150 billion in 2020. That's a best-case scenario. The worst-case, according to its own projections, is 118 billion.

That's still a lot of stamps to sell. The problem is that costs keep rising. The number of addresses the USPS services climbs at an average of roughly 1 million a year as the population grows. Meanwhile, the agency continues to raise the salaries and benefits of its clerks and mail carriers even with periodic freezes.

"I really believe that the USPS is going to get to a point where, regardless of what it does with the prefunding [of retiree health care], it is going to implode," says R. Richard Geddes, an associate professor of policy analysis and management at Cornell University. "It is either going to default on those obligations to its retirees or we are going to have to give it a direct bailout from the United States taxpayers."

The implosion could happen this year because of the stalemate in D.C. Maybe that's what it will take for Americans to get a modern mail service. Even Donahoe, who advocates something less, sounds as if he would welcome it because there's no other way out. "Some people say if you crash the system," he says, "then people will pay attention to you." B

—With Sommer Saadi and Angela Greiling Keane

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THE AUTISTIC, ENCYCLOPEDIC, ECONOMIC, ELECTRONIC, IDEA ENGINE

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Tyler Cowen has written a bestseller on economics, keeps one of the field's most influential blogs, and reads way too many books.

By Brendan Greeley

Photograph by Andrew Hetherington

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COWEN IS A PRAGMATIC LIBERTARIAN. HE'S

Tyler Cowen sits with a cranberry juice and a pile of books he no longer intends to read. He's at Harry's Tap Room, near the Air France ticket counter in the main terminal of Dulles International Airport, on his way to São Paulo. Two days ago he e-mailed me his reading list for the trip—27 books—and I vowed to keep up with it. Already, before he boards, he has assembled a pile of discards. "Unger. I'd say I browsed it. I looked at every page," he says. "There's nothing wrong with the book. It's a good book to stir up leftists." Roberto Mangabeira Unger's *The Left Alternative* falls with a thud to the table.

Cowen, 49, has round features, a hesitant posture, and an unconcerned haircut. He handles each book as he ticks it off his list. "This I discarded. It appeared to get a good review, but there's no framework, just scattered vignettes. I looked at 20, 30 pages." Sarah Vowell's *Unfamiliar Fishes*, thud. Cowen's first rule of reading is as follows: You need not finish. He takes up books with great hope and no mercy, and when he is done—sometimes after five minutes—he abandons them in public, an act he calls a "liberation."

In January, Dutton published Cowen's e-book, *The Great Stagnation*. It has shown up twice on the *New York Times*' e-book bestseller list. Dutton, a Penguin imprint, will release a hardcover edition on June 9. David Brooks has called it "the most debated nonfiction book so far this year" and leaned on it for a column in the *Times*. "In terms of framing the dialogue," wrote Kelly Evans for the *Wall Street Journal*, "Tyler Cowen may well turn out to be this decade's Thomas Friedman." The year is young, but among wonks the book has reached that most coveted of states: It must be responded to.

Cowen thought it was too long for a magazine article and too short for a book, so he suggested that the publisher offer it only as an e-book. The work is priced on Amazon.com at $3.99 for 15,000 words. Cowen gets the sense that Dutton humored him, both on the format and the content. "In a way [neglect] was a bonus," he says. "If this were like the second coming of Harry Potter, everyone would have had an idea about how it should be written." Now most reviews point first to the road it paved as an e-book before moving on to the importance of Cowen's ideas.

The Great Stagnation runs through three centuries' worth of what Cowen calls the "low-hanging fruit" of economic growth: free land, technological breakthroughs, and smart kids waiting to be educated. For developed economies, he argues, none of these remains to be plucked. Yet America, Europe, and Japan have built political and social institutions on the assumption of endless growth. Cowen summarizes the financial crisis in eight words: "We thought we were richer than we were."

It's not that he disagrees with any of the better-known explanations for the crisis—easy credit, flawed ratings—it's that he sees a more fundamental problem, one that can't be fixed with regulation, bailouts, or tax cuts. Cowen thinks that now that America has used up the frontier, educated all of the farm kids, and built a couple of cars for every family, we might be done growing for awhile. *The Great Stagnation* is a short work, simply written. It avoids any but the most basic discussion of economics, yet also brushes lightly over all of modern history; behind simplicity in style and argument lies a lifetime of intensely productive reading.

Tyler Cowen has read what's listed in Harold Bloom's *The Western Canon*, though not, he concedes, every single last one of the Icelandic sagas. He rereads what you probably haven't heard of, like Anton Chekhov's *Sakhalin Island*. For the Brazil trip, in case he runs out of new books, he has also brought Neal Stephenson's 1,100-page *Cryptonomicon*, which he has already read. Fiction slows him down, he says, which makes packing easier. He carries a Kindle but reads paper when he can; he says he's invested too much time on the rhythm of how the eye tracks the page. Several people have told me the same story about Cowen: They have watched him read, and he scans a page as others might scan a headline.

He has a PhD in economics from Harvard University and holds the Holbert C. Harris Chair of Economics at George Mason University in Fairfax, Va., where he's taught since 1989. He runs the university's Mercatus Center, a libertarian think tank, and has published 15 books and over 60 academic articles. In May the American Institute for Economic Research asked academic economists to name their favorite economists under 60. Cowen ranked 16th. Not shabby—he's only five thinkers behind Ben Bernanke, the current chairman of the Federal Reserve.

Cowen is still best known for the blog he shares with Alex Tabarrok, Marginal Revolution. The same survey listed Cowen and Tabarrok's blog as the second-most popular on economics. Greg Mankiw's eponymous blog at Harvard just edged it out; both picked up far more votes than Paul Krugman's *New York Times* blog Conscience of a Liberal, which ranked third, or Freakonomics, at fifth. That's among economists. According to Compete.com, Marginal Revolution gets more unique visitors than any other blog in the AIER survey's list, except for Krugman's and Freakonomics, both hosted by the *New York Times*. Cowen and Tabarrok, who also teaches economics at George Mason, started the blog in 2003. There were few economics blogs at the time, and Cowen thought the two might have a comparative advantage; they had collaborated on papers since 1990, and have together published an introductory textbook on economics (as have two of the other top five economics bloggers).

In his posts, Cowen often serves as a kind of agony aunt for intellectuals. On May 9 a reader asked about the best books on American history and culture written by foreigners. Cowen suggested Vladimir Nabokov and Ayn Rand and linked to a two-year-old list of fiction in the *Wall Street Journal*. In the same week he summarized a book on the origins of World War I, recommended the Chinese food in the basement of the Golden Mall in Queens, N.Y., and asked his readers to name the best pop album that never caught on. Cowen blogs like he reads: prolifically and about pretty much everything.

At the bar at Dulles, he produces David Goldfield's *America Aflame*, a three-inch-thick hardback on the Civil War. He pats

FOR FREE MARKETS, BUT HE DOESN'T GET ALL HUFFY ABOUT IT

it like an obedient dog and urges me to open a page at random and read a paragraph. "It's clear," he says, "it's about stuff." When we're done eating, he offers me a plastic bag filled with the books he's liberated, tells me that reading is the handmaiden of travel, and heads for security.

When Tyler Cowen was 15, he became the New Jersey Open Chess Champion, at the time the youngest ever. At around the same age, he began reading seriously in the social sciences; he preferred philosophy. By 16 he had reached a chess rating of 2350, which today would put him close to the top 100 in the U.S. Shortly thereafter he gave up chess and philosophy for the same reason: little stability and poor benefits.

He'd been reading economics, though. He figured that economists were supposed to publish, and by age 19 he had placed two papers in respected journals. As a PhD candidate at Harvard, he published in the *Journal of Political Economy* and the *American Economic Review*. "They were weird, strange pieces," he says, "but still in good journals, top journals. That cemented my view that I could, you know, somehow fit in somewhere." I ask him what he was like, what made him doubt he could fit in.

"I was like I am now."

"You've always been like that?"

"Always. Age 3. Whatever."

"What did you do at age 3?"

"Read a lot of books."

Cowen speaks in short, declarative sentences that follow each other like steps in a proof. When the proof ends, he is not afraid of silence. In a man with straighter shoulders this might come off as overconfident, but Cowen also listens generously. He says "yes" like a Scandinavian, with a cautious intake of breath, as if to say that you are so often right that it would be rude to spend too much time on it. And he's funny. In April, I sat in on a seminar he teaches on literature and law that puts 10 students at a conference table, each with a pile of books. (George Mason's law school needed someone to teach the class, so he volunteered outside of his department.) Cowen got laughs, and not tentative chuckles either. He got class-stoppers out of *Bartleby, the Scrivener* and Edgar Allan Poe.

"He asks the right questions," says Megan J. McArdle, "which is a gift." McArdle, a friend of Cowen's who writes about economics for the *Atlantic*, offers a story from a conference. An economist had complained about the pharmaceutical company "cheerleaders" who visit doctors' offices to promote prescription drugs, and suggested that the government fund drug research. "Yes," said Cowen. "But what do you do with the cheerleaders? They provide a function, they get into doctors' offices and make doctors listen. Will the government have to hire cheerleaders?" Cowen refuses to scold. He begins his analyses by assuming that if a market, or a person, behaves in a certain way, moral failure is the least likely explanation.

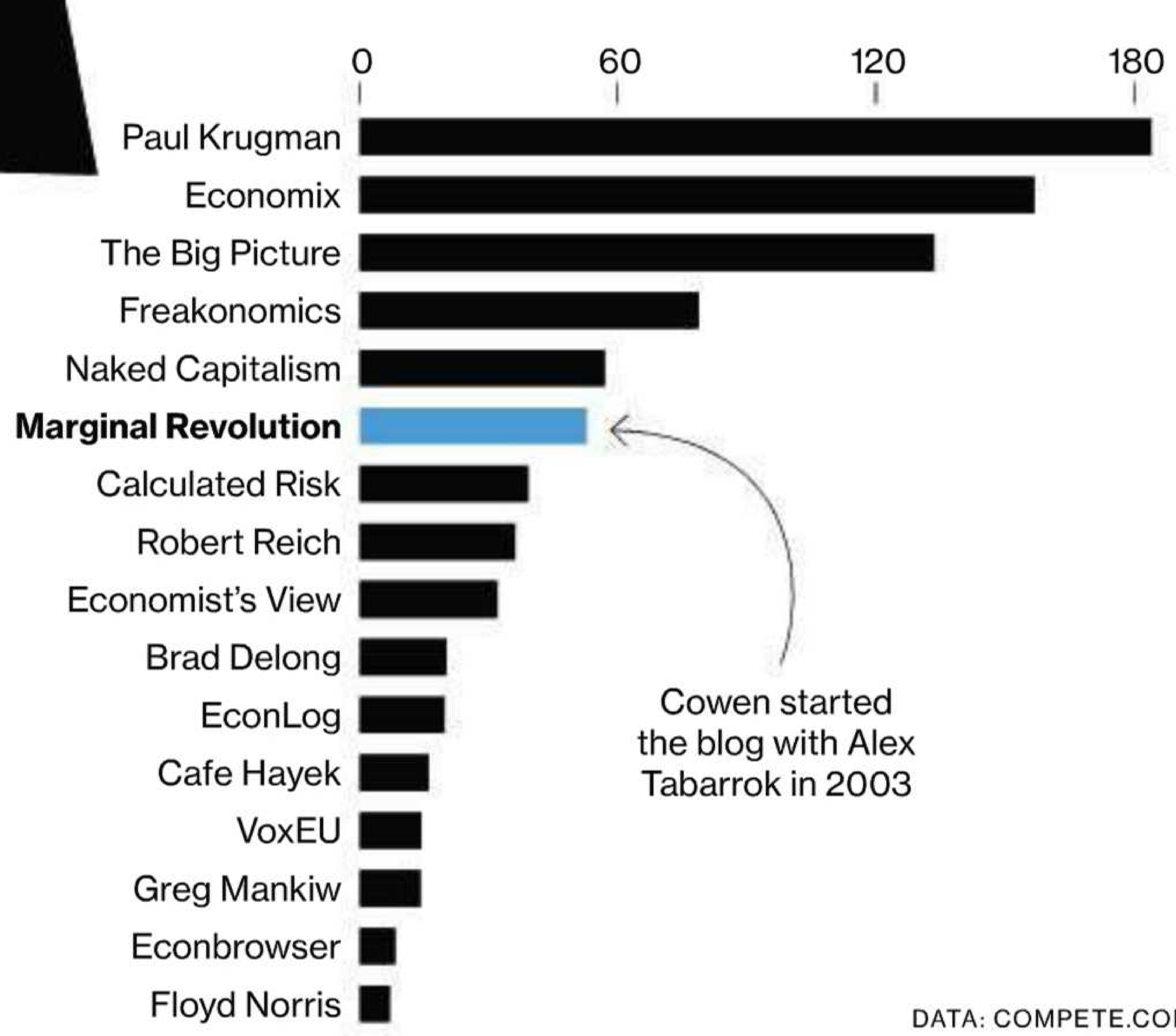
Bryan Caplan, a colleague at George Mason, gushes about Cowen's fundamental decency and civility. He also says that other economists avoid challenging him directly for fear of being made to look a fool. "When I criticize him in public," says Caplan, "I get covert high fives."

Three days after leaving for Brazil, Cowen e-mails that he has liberated *America Aflame* on a plane. "Contrary to expectations," he writes, "it turned out to be pretty boring." He has finished *Starved for Science*—a plea to allow biotechnology into Africa—and moved on to Aleksandr Solzhenitsyn's *In the First Circle*. His wife had recommended it. Her grandfather had spent 17 years in a Soviet prison camp. "Very, very good," writes Cowen.

Since the late '90s much of Cowen's work has looked at the economics of culture. He consumes art and music at the rate he does books, but unlike most critics he doesn't sniff that markets have either ruined culture or brought it low. In 2002 he published *Creative Destruction*, which argues that globalization created much of the art and music we might consider "native." Reggae in Jamaica, for example, borrowed from commercial rhythm and blues broadcasts that drifted over the water from New Orleans and Miami. The fur trade and the metal knife helped create the totem poles of the Northwestern American Indians. But the book also introduces the idea of a distinct "ethos" in creative cultures, which Cowen admits is hard to define for an economist. And *Creative Destruction* points out that the global markets that spur innovations in art can also, eventually, build a demand that discourages further changes. Tyler Cowen is a pragmatic kind of libertarian: He's for free markets, but he doesn't get all huffy about it.

"I write books to solve problems for myself," he says, "to figure things out. Things bug me, in a Lieutenant Columbo sort of way." He began work on *The Great Stagnation* by

Top economics blogs by unique visitors, April 2011 (thousands)



DATA: COMPETE.COM

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IN 2004, A READER SUGGESTED TO HIM THAT HE MIGHT BE AUTISTIC

wondering why growth rates for median wages were failing to keep up with either those for the highest earners or with gross domestic product. Economists on the left have called this trend "income inequality" and blamed it on policy; economists on the right have maintained either that it's not a problem or that it's being measured wrong and doesn't exist in the first place. Cowen had been skeptical himself, but saw too many bits of evidence to ignore: sports salaries, data on executive compensation, the gulf between J.K. Rowling's fortune and what other authors make.

Then the financial crisis happened. "For something so fundamental to have gone wrong," he says, "my intuition and the evidence suggest that there's something wrong with the real economy as well." Maybe the two were related, he thought: What if the financial system took on so much debt because most of us assumed that growth was eternal? Cowen says he has no grand plans when he begins to write, just what he refers to as myopia. What looks strategic from the outside is just Cowen refusing to let something go.

In 2004 a reader of his blog suggested to him in an e-mail that he might be autistic. Offended at first, he applied himself to understanding the term, then decided he has what he calls an "autistic cognitive style," then wrote a book about it, *Create Your Own Economy*. (Cowen never sought a professional diagnosis.) He treats autism as he does the drug company cheerleaders, with neither pity nor celebration. It's not that he denies that autism exists, rather he points out that there is some joy in obsession. He describes people with autism as "infovores" who are attracted to information—the minutiae of train schedules. Or books. He mourns the coming end of big-box bookstores and the enchantment he felt circling the new release table. He goes to the public library twice a week, chasing after serendipity. He has no algorithm for finding a book. If he is intrigued, he buys. "When economists look at what other people call pathologies," he says, "they see reason, they see specialization, they see intent. They see a lot of pleasure."

A week after leaving for Brazil, Cowen e-mails that he is enjoying Steven Levy's *In The Plex*, about Google. "We'll see if it picks up in intensity," he writes. "If it doesn't, I'll stop by the halfway point." He has liberated two more books, spent a disappointing hour in an English-language bookstore, and found good material in Francis Fukuyama's *The Origins of Political Order*, though he can't yet see it coming together. He has started Mat Johnson's novel *Pym*, and abandoned a biography of Otto von Bismarck at the 60 percent mark on his Kindle.

At Dulles, Cowen noted that most economists don't read, at least not widely. Robert Frank agrees. Frank, who teaches economics at Cornell University, says the ascent to tenure leads young economists toward math and small questions. Universities hold on to only the leading figures in each academic sub-specialty. "You want to climb to the top of a hill," says Frank, "and it's a lot easier to climb to the top of a small hill than a big broad one."

In some ways, Cowen has skipped a step in the normal path of the economist from academy to celebrity, which may explain why three notable economists contacted about Cowen declined to comment. There's an idea among academic economists that the privilege of writing a narrative argument must be earned through the hard work of modeling and econometrics. "There is a view that what can't be disproven isn't science," says Raghuram Rajan, a former director of research at the International Monetary Fund who now teaches at the University of Chicago Booth School of Business. He has published his own work for a general audience, most recently *Fault Lines*, on economic risks the financial crisis has yet to uncover. Rajan doesn't think that narrative economics is any less difficult than writing models. "I don't see your having to prove yourself before moving on to something that is 'less rigorous,'" he says. "Both are hard. Both are important." Tyler Cowen can do the math, but he works in narrative. "Economists talk of models," he says. "Is a novel a model? What do you learn about society from novels? They're false, but so are models."

After Cowen gets back from Brazil, we meet at Eyo Restaurant & Sports Bar in Falls Church, Va., an Ethiopian place that sits in a strip mall underneath several housing towers. This is yet another of Cowen's enthusiasms: searching for food, and recording it on Tyler Cowen's Ethnic Dining Guide, another blog. He's included rules on how to find a restaurant and how to order when you get there in a book, *Discover Your Inner Economist*. For one: Order the strangest thing on the menu—chances are the chef put the most work into it. And the best ethnic food, he writes, is prepared at strip malls. He orders for me, then asks whether I eat raw beef.

We talk about his department. For the last fifteen years, Cowen has had a strong hand in new hires for George Mason. The school looks for economists who are undervalued elsewhere. Cowen finds economists as he does books, by curiosity and faith in chance. When Caplan, then a graduate student, mailed Cowen a critique of one of his papers in 1994, Cowen began a correspondence and hired him in 1997. "I've been arguing with him since I met him," says Caplan, "but he's bent over backwards to help my career."

Harvard or MIT, ranked first and second by *U.S. News & World Report*, wouldn't need this strategy, but it's starting to pay off at George Mason. The economists at GMU, he says, have been getting offers elsewhere and turning them down. They like each other too much. (Caplan has said this, too.) "You get to talk about ideas the whole time," says Cowen, "not about local politics or the real estate market, not about sports. You get to talk about ideas, from one second on to the end of the conversation." He's enough of a regular at Eyo for the waitress to volunteer, "We love him. We wish he'd come more often." When we're done, I ask for the bill, and he gathers his stack: three paperbacks, four hardcovers, and three stapled printouts. Ⓑ

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The New Hi Robbery

Boosting trucks laden with pharmaceuticals is



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a low-tech, low-risk road to riches for organized criminals. By Daniel Grushkin



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At twilight on June 17, 2009, Ricky Gene McNew pulled his plum-red big rig into a TravelCenters of America truck stop in Denmark, Tenn. McNew had been driving all afternoon, starting from Louisville (Ky.), and hauling $10 million in pharmaceuticals. He was bound for Memphis, to the warehouse of a medical supply wholesaler. McNew filled his tank and headed into the truck stop for a shower. When he came out, his truck was gone.

The thieves had stolen goods worth about 100 times the average taken in a bank robbery, and there wasn't a single witness. McNew's cell phone had been inside the truck, along with the spare key, so he had to go into the cashier to call his dispatcher. The dispatcher called the owner of the trucking company, Steadfast Transcontinent.

Thus began a chain reaction that threatened the nation's drug supply. The drugs were owned by the U.S. division of Tokyo-based Astellas Pharma. It was Astellas's first experience with a stolen truck, and a shock to the company's directors. On the advice of the Food & Drug Administration, they started calling everyone in the supply chain that night, from wholesalers to hospitals, to warn them that the stolen drugs might surface in their facilities. The lost truck had contained 18 pallets with 21 different medicines. They were concerned about the release of all the medicines, but an immunosuppressant called Prograf was especially troubling. The drug prevents patients from rejecting transplanted organs such as hearts, livers, and kidneys. The pills are sensitive to temperature and humidity, and if left in an uncooled trailer or warehouse, can fail and result in major complications for a transplant recipient.

Within a week, Astellas withdrew all the drugs on the marketplace from the same lots as those on the stolen load. Pills—even legitimate ones—in drugstores and hospitals nationwide had to be destroyed. The $10 million theft ballooned into a $47 million loss. It wiped out 10 percent of the company's North American sales for the quarter—a sudden, multimillion-dollar setback that's becoming increasingly common for companies who rely on America's highways.

FreightWatch International, an Austin-based cargo security firm, collected reports of $425 million in stolen cargo in the U.S. last year. Conversations with numerous FBI employees suggest thieves could be making off with far more, with estimates ranging from $10 billion to $30 billion a year.

"You name it, they're taking it," says Susan Chandler, executive director of the American Trucking Assn.'s Supply Chain Security and Loss Prevention Council. "Do I think there's a surge? Absolutely."

With more than 2 million trucks on the road in the U.S., some 63 percent of all freight travels in trailers. Thieves exploit the weak links in this supply chain, including poorly guarded warehouses and truckers who fail to heed shipping rules. McNew, for example, had told the police that he knew he was supposed to fuel up before leaving the warehouse, in order to be able to outrun would-be thieves, but he left with the tank a quarter full and had to stop, the police said.

The biggest vulnerability, however, is a lack of coordination across jurisdictions. Police departments are geared for local crime, but when the target and the crook are both passing through, the location of the theft becomes incidental. By the time patrolmen begin investigating the lost trailer, the truck is likely out of the county. If a criminal is arrested, the sentences are often so light that many county attorneys don't bother prosecuting.

"The problem is that it's so lucrative and the risk is so low," says Ed Petow, the former commander of the Tomcats, a task force in Miami-Dade County that unites local and state police detectives with federal agents to combat cargo crime.

"By comparison, every bank robbery in the U.S.—whether they take $10 or $10 million—is ultimately investigated by the FBI," says Chuck Forsaith, chairman of the Pharmaceutical Cargo Security Coalition. "Cargo theft is different. A tractor-trailer stolen in Opelika, Ala., with $10 million in fragrances, or pharmaceuticals, or tobacco—you know who's going to investigate that? The midnight guy in the Opelika P.D."

Though it can be hard to estimate the full extent of cargo theft—defined by the FBI as goods stolen mainly from trucks but sometimes from shipping containers, cargo planes, and warehouses—the boosting of freight in transit is clearly on the rise. FreightWatch reports a 30 percent increase in heists since 2007.

Nearly half of all cargo thefts are committed by organized specialists, Petow says. A number of these, according to Petow and members of the FBI, are carried out by a syndicate based in South Florida, many of them Cuban. These crews roam the country's interstates, targeting trucks carrying cosmetics, designer clothes, and electronics. The crews average $471,000 a load, according to FreightWatch intelligence director Dan Burgess.

Pharmaceuticals, however, are the top prize. An average stolen truckload of drugs is worth $3.8 million, according to Burgess, and in the past five years, the number of pharmaceutical cargo thefts has multiplied more than four times. According to officials in the FDA office of criminal investigations, the thieves often pair with launderers who channel stolen or counterfeit prescription drugs, sometimes expired, back into the market. Only a week before the Astellas load disappeared, a patient walked into The University of Texas MD Anderson Cancer Center in Houston with abnormal glucose levels. The Novo Nordisk insulin (branded as Levemir) he had bought at

An average stolen truckload of drugs is worth $3.8 million. In the past five years, the number of pharmaceutical cargo thefts has multiplied more than four times

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Clockwise from upper left: Part of a $3.2 million cache of stolen cigarettes; trailers outside the warehouse; $10 million in stolen pharmaceuticals; the empty warehouse

a local pharmacy had failed. It had come from a trailer stolen in Conover, N.C.

In March 2010, thieves pulled off the highest-value cargo theft in history, in a night raid on an Eli Lilly warehouse in Enfield, Conn. They cut a hole in the roof and rappelled down to avoid the security system. Once inside, they disabled the alarms, then pulled a tractor-trailer to the loading bay and cleaned the warehouse of $76 million in antidepressants, including Prozac and Cymbalta. The police never found the drugs or the trailers.

"I don't call them cargo thieves. I call them entrepreneurs," says Petow. "In cases where we've been able to track stolen cargo, it pretty much mirrored the legitimate export process. The best guess—and it's strictly a guess—is that 50 percent of the stolen goods are exported to South America and the rest redistributed inside the country."

Walt Robinson, 46, is a detective on the Palm Beach Auto Theft Task Force. He stands 6 feet, 2 inches, with a salt-and-pepper goatee and a military haircut, and favors a polo shirt and cargo pants, along with a utility belt holding handcuffs, a flashlight, a badge, and a Glock. In the back of his SUV, he keeps two lockers stocked neatly with items such as grease cleaner, steel brushes, and screwdrivers, which he uses to scrape away the grit obscuring vehicle identification numbers on stolen trucks. When he's done, he wipes his tools clean and places them carefully in their designated drawers.

As the Palm Beach Sheriff's Office detective charged with investigating cargo theft, Robinson has had his hands full since 2008. Thieves weren't only targeting out-of-state haulers. They were picking off easy hits around town. Between 2007 and 2008, the incidence of trailer thefts in Palm Beach rose from three to 22.

"That's when I really opened my eyes to cargo theft," says Robinson. Contacts at the Tomcats, the cargo theft task force, taught him that crews of four travel in two rental cars—rented, because the plates are harder to track—and a "bobtail," a truck without a trailer. Their pursuit often begins when a rig leaves the manufacturer. The average trucker takes a load 500 miles, giving the thieves a number of opportunities along the way. If the driver steps away, a thief can break in and drive away within two minutes. All it takes is a dent puller, which is normally used to smooth dings from car bodies, and a flathead screwdriver (total price on Amazon: $19.69). The thief yanks the ignition key cylinder out with the dent puller, and then twists it with the screwdriver as if that were the key.

The first half-hour is the riskiest. The thief must travel far enough from the truck stop to switch the trailer to his own bobtail, then paint over any logos on the trailer and disable the GPS transmitters with which most trucks are equipped. With all that done, the trailer can't be tracked, and if the truck does get pulled over by police, the driver has the proper paperwork and no identifying marks on the trailer.

Catching a thief in the act boils down to luck—being at the right truck stop at the right time. In order to shut down an operation, detectives focus on the warehouses where stolen goods get stowed. "Put yourself in the thieves' shoes," says Alex Peraza, an FBI special agent based in Miami and a member of the Tomcats. "Once they steal it, where the hell do they put the thing?"

In April 2007, before the Astellas load went missing, Robinson received a tip from detective Willie Morales of the Miami-Dade County Police Dept. A member of the Tomcats, Morales had just returned from an East Texas jail, where he'd interrogated a cargo theft ringleader who had been in a cell for two weeks waiting to post bail. The man was angry, not at the police, but at his own gang; they had refused to give money to his wife and newborn baby while he was in jail.

Crews like these are tight, according to Petow. They abide by a pact that if one gets caught, the others help. They post bond, pay for a lawyer, and most important, take care of the family. The leader had been betrayed, and his revenge came as an account of his crew and their operations.

The jailed informant, whose name has been withheld at the request of Morales, said he'd been replaced by his partner, Armando Canaura. Canaura lived in Robinson's jurisdiction, in an unassuming single-story beige home with a stone façade, a manicured lawn, and a white pickup in the driveway. At that time there was no known link between Canaura and the missing Astellas pharmaceuticals.

As further thefts occurred, Morales's network of informants on the Miami black market said the goods came out of Canaura's alleged network. The trick was to find his warehouse, and that meant studying Canaura—where he went, whom he spent time with, what he did. Robinson convinced his boss, Lieutenant Mike Wingate, to lend him all eight members of Palm Beach's Auto Theft Task Force to stake out Canaura.

According to Robinson, Canaura's associates had one thing in common. At one time or another, they had all used his address as their own. Robinson couldn't prove it, but he suspected that the men joined the theft ring in exchange for being smuggled into the country. "They would come through him and then they'd owe him. That's how he'd recruit guys for work," says Robinson.

That's common, according to Morales. The 1996 Cuban Adjustment Act grants asylum to any Cuban who

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sets foot in the U.S., and young men willingly risk incarceration for a way into the country. "They'll start out as lumpers offloading trucks," says Morales, "then move up to going around the country on heists. They have no past, so in most places they'll be able to bond out if they're caught, and they can't be deported."

While the other detectives investigated Canaura's associates, Robinson says he parked his car in a cul-de-sac opposite Canaura's home, just behind a row of high bushes. For nine hours a day, Robinson recorded the numbers on the plates of the cars that continually pulled up to Canaura's house. When his shift ended, another detective in another unmarked car would replace him. People went in and they went out, but the shades on Canaura's windows were always closed. No one even took the trash out.

When he wasn't on stakeout, Robinson made his way through records of phone calls intercepted at cell towers, hoping to tie Canaura or one of his men to the scene of a theft. In his office, Robinson built a criminal hierarchy, putting together a chart over his desk of Canaura and his associates, most of whom lived nearby, noting their criminal records, spouses, properties, and finances.

Robinson began to draft what he believed was a modus operandi for Canaura. The trailers were mostly stolen in Tennessee, Kentucky, and sometimes Texas. Logos were always painted over. The tractor was abandoned immediately, and the goods were always high value.

From his car, Robinson would sometimes watch Canaura—thickset and bald, with a jutting forehead and acne scars over his cheeks—lug a fishing rod and cooler of bait over to the canal. He often wore an old T-shirt, a loose-fitting pair of shorts, and flip-flops. He never seemed to have to go to work.

After three weeks, the investigation started to peter out, and the recruited detectives drifted back to their own cases. Canaura never seemed to go anywhere but his brother Jose's house down the street, or fishing. To save manpower, Robinson requested a court order to hide a tracking device on Canaura's pickup. To install it, the police would need to steal the vehicle and install the beacon back at their own garage. The operation became more difficult when Robinson got a call from his sergeant about a police run-in with Canaura.

On May 15, 2008, at about 10 p.m., a driver tried to tow Canaura's truck, which had been parked illegally on the street, according to the police report. The driver, Albert Lee Clark, was about to pull away with it on the back of his truck, when Canaura and six other men poured out of the house and surrounded his cab. They beat on the windows with their hands and yelled in Spanish. Clark, according to the report, watched Canaura cock a handgun and put it to his side. Within a few minutes, three policemen arrived.

A scuffle ensued, and ended with an officer shooting Canaura with a stun gun. Canaura pled guilty to improper exhibition of a weapon and resisting an officer.

Robinson made his move a few weeks later, at three o'clock in the morning. Two detectives from his cadre, detective Mike De Bree of the Delray Beach Police Dept. and Chris Suarez, an auto crimes detective with the Boca Raton police department, crawled into the scrub opposite the house. They lay flat and trained rifles on Canaura's front door, in case he burst out with a gun. From down the street, a detective snuck toward Canaura's truck. He tried to open the door with a specially made key, but he was so shaky he couldn't get the key in properly, according to De Bree. Robinson called the operation off.

For his next attempt Robinson paired with repo men, who towed Canaura's truck away in the middle of the night. The following morning Canaura called the police to report the vehicle stolen. Within days, an officer called back to say the vehicle had been found. Canaura didn't know it, but the truck returned loaded with a tracking beacon.

Again, "Canaura went nowhere," Robinson says, at least not in his truck. Robinson had been following Canaura for 18 months, and he had nothing.

Throughout, Robinson had spoken daily with the Tomcats. Among his contacts was Detective Juan Gross, a Tomcat veteran of 15 years who ran a web of informants that helped him track stolen goods. On Oct. 17, 2009, Gross passed on a solid lead. One of his informants had bought samples of cigarettes and Bacardi Select from a man driving a white Acura licensed to the wife of a man named Denis Perez De Castro, according to the affidavit for a search warrant Robinson would later request. Robinson recognized Castro's name; he had lived in Canaura's house. By looking at the packaging, Gross could tell that the cigarettes—including Marlboros, Camels, and Basics—came from a warehouse heist in Georgia three days earlier.

When the man in the Acura, not identified in the warrant, asked the informant to borrow his truck to transport the stolen cigarettes, Gross fitted the truck with a transmitter. He watched the beacon from his computer. On a map, a blinking dot left Miami and headed up the Florida Turnpike, past Fort Lauderdale, Boca Raton, and Delray. At Palm Beach it turned inland into Loxahatchee, a town of farmers and horse breeders. The beacon located the truck within a radius of a few blocks.

According to property records, Castro's wife owned a second home in the town that sat opposite a preschool on Okeechobee Boulevard, a sandy street of farms that dead-ended at a drive-through safari park. It was a beige, single-family home with a chocolate brown roof, hidden behind a row of high bushes. It had a very large separate garage, big enough to conceal a trailer. When Robinson went up, he found two container trailers parked on the side lawn.

Three days later, Robinson assembled the Auto Theft Task Force in undercover cars and vans a few blocks from the house in a lot down the street. Robinson says Gross had told him that Castro had been peddling the cigarettes and rum in Miami again, but the buyer hadn't shown. Gross expected Castro to return to the warehouse with a full trailer. By 7 p.m. Robinson still didn't know whether or not Castro had returned. He hoped that the trailer was inside the garage. If they raided an empty house, the 18-month investigation would be destroyed. The element of surprise would be gone, and Robinson feared the operation would be rebuilt somewhere else. As Robinson tells it, his boss, Lieutenant Wingate, pressed him to serve the warrant anyway. Or as Wingate put it, "S--t or get off the pot, Robinson."

Wingate was asking Robinson to embrace chance, and that countered every one of his methodical steps to build the case. Finally he said, "Ah, you know what, f--k it, let's do it."

Just as Robinson started his car, a pickup truck followed by a tractor-trail-

Left to right: Armando Canaura, Servando Gomez, Denis Perez De Castro





er came down the road. Robinson pulled out behind the trailer, and followed them to the house.

The six undercover police cars pulled up around the truck, lights flashing. Robinson cuffed Castro, who argued that he was just on his way home. The other detectives charged out of their cars to secure the truck, the garage, and the house. Suarez and De Bree banged on the front door, and a Guatemalan man answered. Inside there were guys everywhere, drinking beer in front of a small television, sleeping in a closet, cooking in the kitchen. The detectives marched them outside onto the driveway and ordered them to sit.

De Bree moved to the garage where the detectives expected to find pallets of stolen goods. He unhinged the side door. The concrete and cinderblock husk of a room was empty except for a rusty forklift. The two trailers on the grass were empty, too. But when the detectives pulled the latch on the trailer hooked to the truck they found boxes stacked high with $2.3 million worth of cigarettes.

While the detectives examined the trailer, one of the men who was in the house slipped into a red Chevy. Suarez caught him before he could drive off. The man's name was Servando Gomez, and he turned out to be Castro's brother-in-law. As Suarez cuffed him, he noticed a bottle of Bacardi stuffed in a shopping bag on the passenger floorboard. "Is that yours?" Suarez asked.

"Someone gave it to me," Gomez said. Detective Suarez asked if he had more back at his home. "No," he said, and then added, "I'll show you." Suarez and three other detectives drove Gomez to his house, just a few blocks away. Together they walked up a little slope to the white stucco home. It was about 9 p.m. when Gomez introduced his wife, mother, and son to the group of detectives.

Inside, the detectives found Gomez had been bluffing. They discovered cell phones, razors, and lotions from stolen loads—in all, goods from nine out of the 22 trailers stolen in Palm Beach, according to Robinson. Gomez's wife pulled back the child safety gate that led to a small basement beside the garage, and Wingate went downstairs. There were 400 boxes of Astellas pharmaceuticals, including Prograf. "I think we've got the mother lode," Wingate said. Including the cigarettes and the pills, Robinson's team found $13 million in stolen goods.

In February 2011, after 16 months in the justice system, Gomez pleaded guilty in Palm Beach County Court to grand theft. He received three years' probation. Castro faces trial for grand theft in July; his lawyer did not return three calls for comment. His wife was not charged. Canaura, meanwhile, appeared to have slipped through Robinson's fingers, until November 2010, when four trailers were stolen from an Elizabeth Arden Distribution Center in Roanoke, Va. Three of the trailers were found abandoned in New Jersey. According to public sources, Canaura, along with his brother Jose and Castro (who was out on bail), were found in the back of a gardening center in Winchester, Va., painting over the logo on the fourth truck, which contained $63,000 in perfume.

Canaura is charged with grand larceny. "He hasn't been arraigned yet, so we don't have a plea," says his lawyer, Roger Inger. "So far, I guess, it's not guilty." He is expected to go to trial before a Frederick County jury in June.

Police continue to investigate nearly 20 men connected to the ring. Robinson has joined the Tomcats. He's now investigating a case with agents from the FBI. In Loxahatchee, a couple has moved into Castro's house. They've never heard of the theft, let alone the fact that they live at its epicenter. They have started a tomato farm on the field behind the warehouse. The trailers are gone. B

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SELLER'S MARKET

Once upon a time, foreign companies set up shop in China to save on production costs. These days, they have their eyes on the Chinese consumers themselves

If sometime soon you book a nonstop flight to Beijing, bring along a copy of Angus Maddison's *Chinese Economic Performance in the Long Run*. This seminal work by the late British economist will set you straight on China's putative rise to sudden economic prominence. Maddison applied his econometric tools to the year A.D. 1 and found China's share of aggregate global GDP dwarfed that of the Roman Empire. The Asian giant, it turns out, is enjoying a return to economic-superpower status. In the process, the People's Republic of China both beckons and perplexes the American newcomer who hopes to leverage the world's most revved-up economy.

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Since enacting reforms in the late 1970s and entering the World Trade Organization in 2001, China has been an economic dynamo. Its expansion has been unchecked even by worldwide recession in 2009 (when China recorded 8.7 percent GDP growth) and 2010 (when GDP grew 10.1 percent). The country's economy is more than 90 times bigger than when Deng Xiaoping dropped hard-line Communist policies in favor of free-market activity. Within that growth spurt there has been maturation, as first agriculture and then manufacturing shrunk as a percentage of GDP activity. At the same time, the labor market has experienced supply pressures (or at least imbalances) regionally and by industry.

Of course, labor-force behavior that disrupts the profit model for simpler kinds of manufacturing is part of something else—more acquisitive consumer behavior by an emerging middle class. In fact, most foreign companies that set up operations in China nowadays are looking for access to the Chinese market rather than cheap labor. Longtime participants in this marketplace all cite headaches and pitfalls of conducting business there, but China's growth more than offsets those negatives. When battle-tested businesspeople and policymakers craft advice for newer entrants, two themes dominate: Be patient and expect inherent contradictions in the business landscape.

One incongruity involves the activity and pronouncements from China's central and provincial governments. In their attempts to gain operating licenses or start construction projects, Western companies often find local authorities contradicting official Beijing edicts. That's to be expected. “The mountain is high and the Emperor is far away,” goes a hoary Chinese saying, referring to geographical limits on China's centralized control of commerce and development. According to Jean-Luc Butel, Executive Vice President and Group President, International of medical technology company Medtronic, one critical area that requires the government's quick attention is consumer health needs.

“Non-communicable, chronic diseases like diabetes and heart failure account for more than 80 percent of deaths due to all diseases in China,” says Butel. “This challenge demands industry-government collaboration and innovative ideas.”



Medtronic innovates in a robust but deliberate manner well suited to this environment. In Beijing last August, it opened the world's first patient care center that educates patients on medical technology and what it can do. With the growth of chronic disease and limited patient-physician interaction, Medtronic identified the need to act and address both issues by partnering with the health authorities and a cardiovascular professional society. “In China, any major undertaking by a foreign company takes careful preparation,” says Butel. “Especially now, I hear of U.S. and European companies saying, ‘We've got to get something done in China, that's where the growth is.’ If those companies try to move at a fast pace and leave details of their agreements and partnerships to be figured out later, they are guaranteed to regret it.”

Among Medtronic's vital building blocks for selling in China are its joint venture with a local device company, Weigao. The venture allowed Medtronic entry to key parts of the healthcare segment in China and to leverage the local knowledge of its partner to help drive local business strategies fully realize the market opportunity.

“Made-in-the-USA has enormous appeal to the rising Chinese middle class.”

—Gary Locke



LOCKE: SEONGJOON CHO/BLOOMBERG

Such local knowledge plays well in China. For example, the American fast-food giant KFC is seen by Chinese consumers as a paragon of meat freshness and hygienic food preparation. China's population knows about American standards, and KFC, by virtue of its penetration, owns a good portion of that imprimatur.

One reason American companies now hurry to begin activities in China is the inherent advantage that comes with being a Western brand.

“Made-in-the-USA has enormous appeal to the rising Chinese middle class,” says Gary Locke, U.S. Secretary of Commerce and the only Chinese-American to have served as governor of a U.S. state (Washington). “In 2010 alone, U.S. exports to China grew by 32 percent.” In Locke's view, the statistics and rhetoric surrounding U.S.–China trade relations are difficult to follow without running into confusion or outdated beliefs. John Frisbie, president of the US–China Business Council, is a strong proponent of the value of facts over truisms. “In the first quarter of 2011, China ran a global trade deficit,” Frisbie points out. “You have to go back to 2004 to find the last time that happened. With the U.S., bilaterally they still ran a large surplus, but globally they imported more than they exported. They will revert to a global surplus the rest of this year, but probably at a reduced level versus before. It may be that China is indeed starting to sustainably boost domestic demand.”

This change in balance of imports and exports is part of a plan to advance to a more mature stage for both the economy and the society, observers contend. “The Chinese government wants to rebalance its economic profile through increased consumer spending internally, and, via that process, to lower its trade imbalance with the U.S.,” says Locke. “As the Chinese middle class expands, there's a stronger interest in Western culture and Western goods—that augurs well for us.”

Critics of China's currency valuation policy have had evidence on their side, but are dishing out rhetoric at odds with current facts and figures, says Frisbie. “There's growing recognition by the Chinese government,” he says, “that the exchange rate is a tool to help control inflation. China imports energy, commodities and food, and



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IT's Alive!

The Liangjiang International Cloud Computing Center is going to be, well, huge

From Hainan Island up through Hong Kong and Shanghai to Beijing, China's coastal crescent has seen most of the country's growth. Aware that economic activity tilted eastward, Beijing planners have long crafted ambitious plans for the central and western sectors. John Frisbie, president of the US–China Business Council, returned from a recent gathering with a relevant comment.

"I was in a roundtable conference with 60 or 70 executives of global corporations," Frisbie says, "and they reported on ramped-up activity far from the coastal centers. China's third- and fourth-tier cities are beginning to be targets of sales growth for multinationals." Thus, American businesses that feel left behind may wish to focus inland, on Henan, Hunan, Shanxi and Chongqing. The latter, pronounced "chong-ching" and poised at China's geographical center, is home to bustling manufacturing, sundry corporate outposts (Ford, Walmart, Honeywell, IBM, Microsoft) and, in development, a financial center and cloud computing center of mammoth proportions. Like most large-scale undertakings in China's interior, the Chongqing Data Industrial Campus, in the Liangjiang New Area, follows a master plan and offers inducements to foreign companies that invest or set up shop there. Incentives include a reduced enterprise income tax rate of 15 percent through 2020 for companies operating in "encouraged industries."

The initial footprint of the Liangjiang International Cloud Computing Center is planned at 135 acres, with a gross floor area in the compound of 2.07 million square meters. Huang Qifan, the mayor of Chongqing Municipality, calls the project "a key step toward building the largest data processing center in Asia." Envisioned over time is a development area of 2,471 acres for cloud computing that would house 200,000 servers and routers. It will initially provide IT infrastructure for the governments and enterprises of Chongqing and other regions of Southwest China, then expand to become a service outsourcing platform. ●

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a stronger exchange helps control those price pressures." On that basis, a continued hands-off approach to the currency is likely; the government's target for price inflation is said to be in the range of 4 to 4.5 percent.

A common excuse for delaying entry into China has been concern about placing intellectual property at risk due to factors in the legal system and the industrial culture. It's been observed that, during a long run of success in China, Japanese auto companies take pains to withhold the most valuable technology from the vehicles shipped there. Especially as three-dimensional scanning technology has made it possible to reverse-engineer high-tech products, exporters have feared infringement and piracy. Frisbie, a veteran of two decades in-country, says the problem remains a top concern—especially for software and movie producers—but is showing slow improvement overall.

"We annually survey our members on many questions," Frisbie says. "Consistently, each year more companies say that aspect of China commerce is getting better. Foreign companies can use Chinese courts more effectively to seek redress. But if the government wants China to become an innovative economy, they have to get much better at protecting IP. Their own domestic companies increasingly demand this, too."

Factories mushrooming across China are a natural sign of economic growth, but they obscure the progress of service businesses. Nicholas C. Walsh, Vice Chairman and Chief Distribution Officer of Chartis, is part of the less visible but deep foray of Western firms filling these needs. "As a company that traces its roots to China decades ago, we have been privileged to witness China's astounding growth," says Walsh, "and to see the services sector playing an increasingly important role in that development." When a company like Chartis makes strides in China, it naturally contributes to better safeguards, efficien-



cies and support for industry in general. "Infrastructure, large-scale development projects, manufacturing, trade and exports are all facilitated, if not made possible, by business and financial services," notes Walsh. "Additionally, a globally competitive services sector encourages high-level efficiency and ultimately better products and prices for consumers."

Like any late-industrializing nation, China must clean its smokestack emissions from the day each smokestack goes up. Observers of U.S.–China diplomacy see particular promise in the combined need for leadership in environmental sustainability. "We're the two leading producers of greenhouse gas emissions," says Commerce Secretary Locke, "and history will judge both America and China on how we address that issue." That's the liability side of the question, but Locke sees an asset as well. "There's a reason why President Obama included $100 billion in funding for clean energy research in the Recovery and Reinvestment Act," Locke says. "This is an area where American technology has excelled and can continue to excel. We need to make our policy more specific regarding R&D tax credits, and that will happen."

For the U.S. and China to make common cause on environmental protection would bode well across many fronts, including technology sharing for reduced dependence on fossil fuels. This will require leadership from younger entrepreneurs and policymakers in both countries.

"China encourages and welcomes American cultural institutions and commercial enterprises to actively engage in and support the cultural exchanges between China and the United States," says H.E. Mme. Zhao Shaohua, Vice Minister of Culture, People's Republic of China. "Together we can help bring about increased understanding and deeper friendship between our two peoples." ●

PORT: THOMAS LEE/BLOOMBERG

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Global Development Strategy

Chongqing, Conduit between China and the West

全球發展趨勢 重庆实践的价值

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In the 20th century, China's economy was driven by the development of its coastal areas. However, more recently, the central government has been pushing its 'go west' reform program, and as the gateway to China's western region, Chongqing is sure to thrive from its yet unexploited opportunities.

The 'Liangjiang New Area' in Chongqing will play a critical role in narrowing the income gap between the eastern and western regions of China. 'Liangjiang New Area' is built to meet the increasing demand from the manufacturing, technological innovation, trade, and financial industries in China's western region, as well as direct investment from abroad.

Chongqing Municipality has taken the lead in organizing the first ever international forum in the 'Liangjiang New Area'. This event will gather prominent thought leaders and industry experts from around the world to discuss the unique opportunities that this area can offer.

The Liangjiang Forum is endorsed and supported by the Ministry of Commerce of the P.R. China, the China Council for Promotion of International Trade (CCPIT), the World Trade Centre Association Hong Kong, Bloomberg Businessweek and Tsinghua University.

Confirmed speakers include:

Mr. Chung Un-chan, Former Prime Minister of South Korea
Mr. Stephen Roach, Chairman, Morgan Stanley Asia
Mr. Gerhard Schroeder, Former German Chancellor
Mr. Henry Chan, Executive Director, Li & Fung Group
Mr. Jacky Chan, CEO, AIA Hong Kong and Macau

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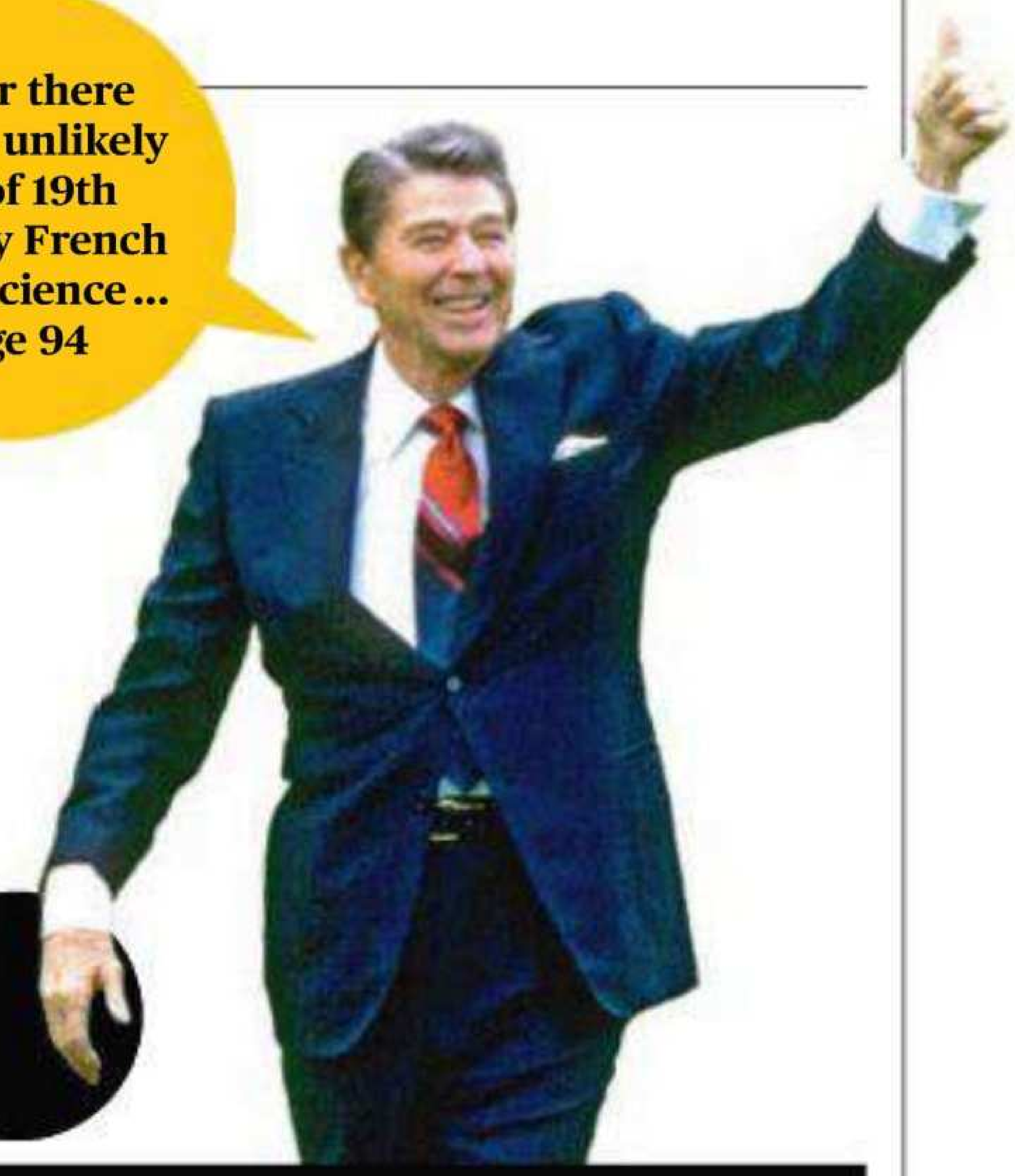
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If ever there was an unlikely fan of 19th century French social science ... page 94





The $140m Bear

Knut and the perils of the high-stakes celebrity animal business.

By Peter Savodnik

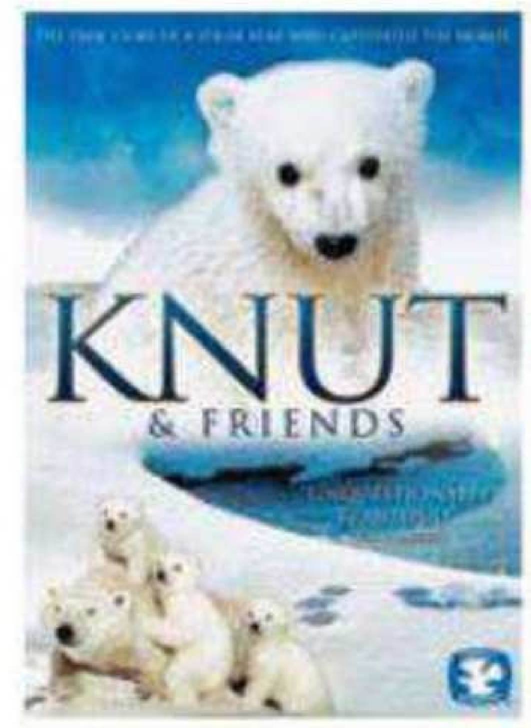
REAGAN: CYNTHIA JOHNSON/TIME LIFE PICTURES/GETTY IMAGES; KNUT: MICHAEL KAPPELER/AFP PHOTO/GETTY IMAGES

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Etc. Celebrity Animals



Both Germany and Azerbaijan put Knut's cuddly face on their postage stamps



The DVD has been selling strong even though Knut was born in a zoo, not the Arctic



Ich bin ein Berliner Volksbank ATM card



The *VF* cover helped rehabilitate DiCaprio's career. The German edition was a fan favorite





Berliners purchased Knut votive candles after his untimely death

As the world's first celebrity polar bear, Knut used to spend his days feasting on raw meat, swimming in a black-bottom pool, and gazing at the hundreds—if not thousands—of visitors who flocked to see him every day at the Berlin Zoo. During his prime, candymaker Haribo churned out 1 million raspberry-flavored Knut gummy bears daily, and Berliner Volksbank issued tens of thousands of ATM cards featuring his furry face. There was also the 2007 book, *Knut: How One Little Polar Bear Captivated the World*, and the 2008 film, *Knut & Friends*. Along with Leonardo DiCaprio, he graced the cover of *Vanity Fair*.

Knut (pronounced Kuh-noot in German) achieved international fame hitherto unknown in the animal kingdom on account of his irresistible story. He was born into captivity in 2006, rejected by his mother, and raised by a zookeeper. To environmentalists, Knut was an emblem of the anti-global-warming movement; to business, he was a cuddly money machine. In its 167-year history, the Berlin Zoo—which is subsidized by the city and listed on the Berlin Stock Exchange—has been profitable for only three years, says Heiner Klös, its animal curator. Those were 2007 to 2009, the Years of Knut, when yearly attendance rocketed from 2.5 million to 3.5 million visitors, and the zoo made more than $30 million. In all, Gerald Uhlich, a former chief executive of the zoo and the architect of Brand Knut, estimates that the polar bear generated more than $140 million in global business.

In 2010, however, Knut grew up and became less cute, and attendance waned. Then in March, he unexpectedly died. Zoo-dwelling polar bears usually live well into their thirties—Debby of Winnipeg made it to 42—but an autopsy revealed Knut had suffered from encephalitis, an inflammation of the brain that caused him to lose consciousness, tumble into the water, and drown in front of several hundred horrified fans.

Now the fate of Brand Knut—unprecedented in the history of brands and animals—is up for grabs. Scores of book publishers, moviemakers, marketers, advertisers, and manufacturers of stuffed animals, lunchboxes, and coffee cups hope to profit before the public's memory of the cuddly cub is replaced with that of a large, dead polar bear. There are already plans for a television documentary in Germany. The chinamaker KPM is issuing $315 commemorative Knuts that have *Zur Erinnerung* ("in memoriam") inscribed on them. Uhlich is writing a book about the untold story behind the rise of "der Icebear." And for good reason. "A dead Knut brand could still make millions," says Birgit Clark, a London-based trademark attorney who has studied the Knut phenomenon.

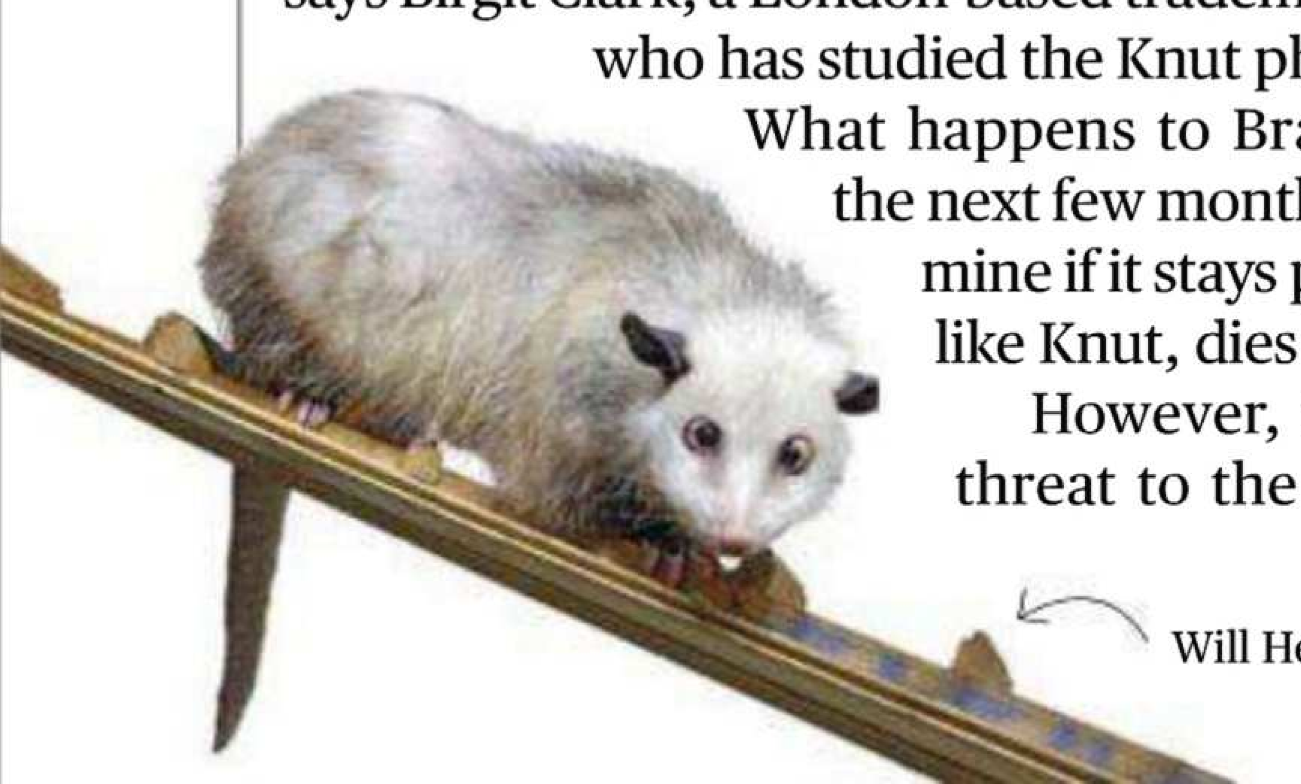
What happens to Brand Knut in the next few months will determine if it stays profitable or, like Knut, dies too.

However, the greatest threat to the brand—and potential Knut profiteers—is actually its owner, the Berlin Zoo, which is reluctant to profit from a dead polar bear. Clark says the zoo licenses the Knut trademark only to outfits deemed environmentally sensitive—those that preserve Knut's image as "an ambassador of climate change," says Klös. This leaves Uhlich, the former zoo chief and aspiring Knut biographer, exasperated. "Brand Knut is established," he says. "There is still greater potential to use it for further products or services!"

"A dead Knut brand could still make millions," says one expert. Many are already trying

Uhlich, who left the zoo in late 2007 amid a rather public philosophical dispute over, among other things, profiting from a baby polar bear, isn't alone. Udo Marin, the chief executive officer of the Berlin Club of Merchants and Industrialists, also believes the zoo failed to exhaust its moneymaking potential. "Knut presented the unique chance to generate so much money via marketing that the zoo could have become independent of state subsidies," Marin says. Yet ulterior motives, he says, led the zoo to resist that. "The traditional zoo director doesn't like the idea of being responsible for a positive net result," Marin says. "He is the head of an educational unit. Education is one of the basic jobs of government." The good thing about governments, Marin says, is that "generally they don't question the wisdom of visiting the umpteenth zoologist congress in Australia or buying a rare bird which no one is interested in."

But if the Berlin Zoo doesn't capitalize on the



Will Heidi (left) eclipse Knut?

THIS PAGE: HEIDI: SEBASTIAN WILLNOW/AP PHOTO; OPPOSITE PAGE: KNUT: MICHAEL GOTTSCHALK/AFP/GETTY IMAGES; NECKLACE: JAN BAUER/AP PHOTO; COIN: ANITA BUGGE/WIREIMAGE; HILTON: SEAN GALLUP/GETTY IMAGES

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What do opossums look like anyway? (See below, left)

It is unlikely that Heidi the opossum will get her own candy

The easiest way to keep Knut close to your heart

This work by American sculptor Daniel Edwards is beyond words

Everyone wanted some Knut magic, including Paris Hilton

The Berlin Zoo made more than $30 million during the Years of Knut

Knut (2006-11), the world's most branded polar bear

memory of Knut soon, the brand may be devalued for everyone. Bernhard Fischer-Appelt, the managing director of FischerAppelt, a public-relations firm in Hamburg that represents the Leipzig Zoo, says the zoo community is eagerly watching events in Berlin. Fischer-Appelt expects that, in a post-Knut landscape, museums will hedge their bets and embrace a new business model, shuffling in one or two celebrity animals per year—each of which, he says, is worth "a couple million dollars" in ticket sales and licensing deals. The Leipzig Zoo is already employing this strategy with Heidi the opossum, the star of an exhibit opening on July 1. Zoo spokeswoman Maria Saegebarth predicts Heidi could be bigger than Knut. "From our point of view," she says, "it's not possible to compare the cases of Heidi and Knut. The attention and interest in Heidi is huge—and no one has even seen her yet."

Other celebrity animals are also threatening to transform the modern zoo into a hotbed of merchandising—including Leo the Pakistani snow leopard at the Bronx Zoo; Miwa the baby monkey and her friend, Uribo, the boar, in Kyoto; and, until recently, Paul the octopus, who lived in an aquarium in Oberhausen, Germany. Paul, famous for predicting the 2010 World Cup winner, had a following—and an agent—when he died in October. His remains were cremated, and a shrine was erected in his honor.

Leo the snow leopard, Uribo the boar, and Heidi the opossum are challenging Knut's status

Yet future celebrity animals may walk a fine line that Knut—or, for that matter, *Free Willy*'s Keiko or Sea World's Shamu—never had to worry about. Many zookeepers increasingly believe giving animals names, background stories, and cuddly personae is exploitative. Yet they also realize that branding them is the only way to make money off them through ticket sales, merchandising agreements, and licensing deals. Indeed, the tale of Knut was partly contrived by the same camp that supposedly opposes telling tales about animals. Ian Sterling, a polar bear expert at the University of Alberta, says it's more common for mother polar bears to spurn cubs in captivity than in the wild—meaning the sob story the Berlin Zoo used to market Knut was, to a degree, its own creation.

This doesn't surprise animal rights activists. "It's always business with zoos," says Ingrid Newkirk, the president of People for the Ethical Treatment of Animals. "Zoo visits are declining because people can see actual animals in the wild. They can see YouTube and National Geographic and the Discovery Channel. Zoos are struggling to make themselves sexy." Yet Klös doesn't see it that way. Knut, he says, remains "the most popular animal in the world, more popular than Mickey Mouse." It's no surprise, then, that the Berlin Zoo is going to erect a Knut statue, which is a good way to lure those who miss him. Still, Klös dismisses talk of a Knut 2.0. "The finance people say it would be wonderful to have another Knut," he says dismissively, before adding: "You can't do *that* again." B

WorldMags

Shoe Complete Me

Listen to what your footwear says about you. *By Darrell Hartman*

There are at least two fast ways to judge a man: by his books and by his shoes. "It's the classic stereotype," says stylist, consultant, and former Saks Fifth Avenue menswear director Michael Macko. Unlike what a man reads on the train, his footwear is on display throughout the day—from board meeting to bathroom stall. And those shoes are always saying something, especially at the office, where these days "we're seeing all kinds of great shoes," says Kevin Harter, director of menswear at Bloomingdale's. Men now are able to get away with wearing a much greater variety of shoes during the workday, in materials ranging from canvas to suede—even alligator—and in styles from strap closures to slip-ons. Color, Harter adds, is one of the moment's big trends. But before you swap out your black oxfords for a pair of yellow suede loafers, stop and consider what that might communicate about you. Better yet, have our panel of experts do it for you. In addition to Macko and Harter, *Bloomberg Businessweek* tapped William White, founder of the high-end shoe brand Di Bianco, and Paul Grangaard, chief executive of Wisconsin shoe manufacturer Allen Edmonds, to offer insight into your sole. Ⓑ

1. Bruno Magli, $425; Bloomingdale's, 800-232-1854 2. Allen Edmonds, $295; Bloomingdale's 3. Ferragamo, $460; Bloomingdale's 4. Jack Purcell, $60; Bloomingdale's 5. Mark McNairy, $350; markmcnairy.com 6. Regain, $550; Bloomingdale's 7. Di Bianco, $6,000; scarpedibianco.com 8. Tod's, $425; tods.com 9. Sperry Top-Sider, $85; sperrytopsider.com 10. Bally, $475; Bloomingdale's

Fig. 1

The Elegant Executive





Elegant but unremarkable, the black oxford is "for the conservative, classic guy who wants to look polished," says Harter. Depending on the audience, though, its conventionality can inspire confidence or doubt. "He's on the hamster wheel," White says. "I worry he's going to try to sell me something."

Fig. 4

The Free Spirit



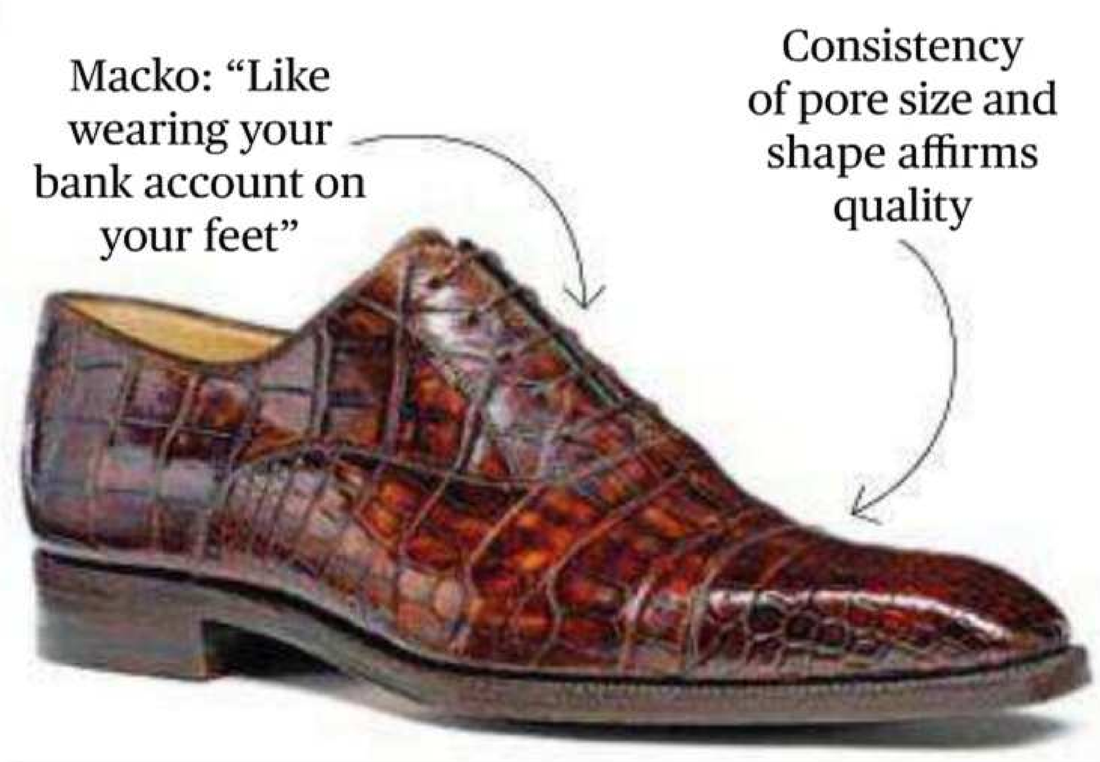


A canvas sneaker conveys simplicity. "He wants to be comfortable and unrestrained," says White. "He doesn't care what other people think." These might be the same shoes he wears on weekends, on dates, or to the gym—although, "he's not necessarily an athletic type," Harter says.

Fig. 7

"That Guy"





Executives at the top of the food chain gravitate toward exotic shoe materials such as alligator skin. "He's into sports cars, private jets, and cigars," Macko says. While five-figure shoes won't go out of style, White says if they're red or blue, they're probably the spoils of "a good weekend in Vegas."

Fig. 8

The Rich Old Man (R.O.M.)





The suede driving moccasin—preferably by Tod's—is the ultimate rich man's leisure shoe. "He's relaxed and doesn't want to wear socks," Harter says. White adds: "His wife or girlfriend spends time looking through the *better* fashion magazines." Macko: "This shoe definitely says, 'I have a country house.'" Or five.

PHOTOGRAPHS BY DAVIES AND STARR; ILLUSTRATIONS BY WARD SUTTON

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Fig. 2

The Sharp Dresser





"He's not cookie-cutter," Harter says of the guy who wears a wingtip brogue with decorative perforations. "He's a gentleman and likes the idea of going to lunch in a three-piece suit." Even if it's a skinny suit with a skinny tie. "It's a fashion look," Macko adds. "He's willing to take risks, but ones you usually win."

Fig. 3

Mr. Ubiquitous



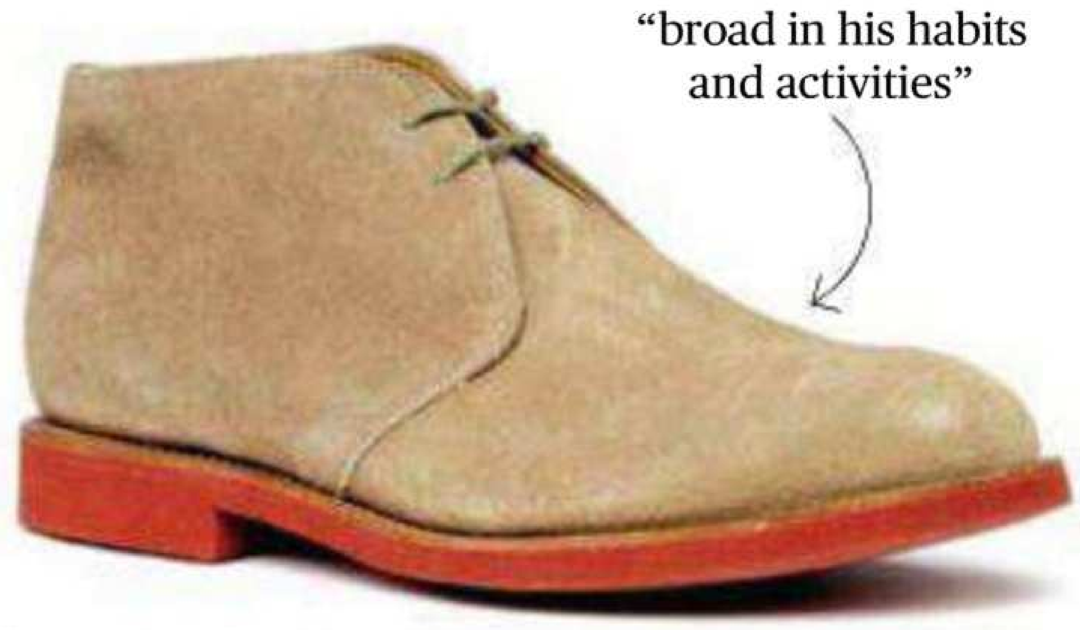


The universal penny loafer–alongside its frilly cousin, the tassel loafer–is the default shoe for corporate casual, whether you're "a khaki-wearing dot-com CEO or a lawyer who doesn't have to be in court," Macko says. Though Harter points out, "More hip guys are wearing these with suits."

Fig. 5

The Dudeademic





The suede chukka is both casual and dressy, purposeful and bohemian. "He travels, maybe has a little country in him–or he could be an academic," White theorizes. Either way, he's versatile. Notes Macko: "He's a little more cerebral and creative. He has a Nerf basketball hoop on his garbage can."

Fig. 6

The Uninhibited Aristocrat





A monk-strap oxford is a "jaunty" alternative to the lace-up, notes White. A double-monk in blue suede, however, is "a shoe that you need a valet for," Macko says. Worn with some restraint, it conveys sophistication. At its fussy extreme, he argues, it's decidedly "more femme than butch."

Fig. 9

The Drifter



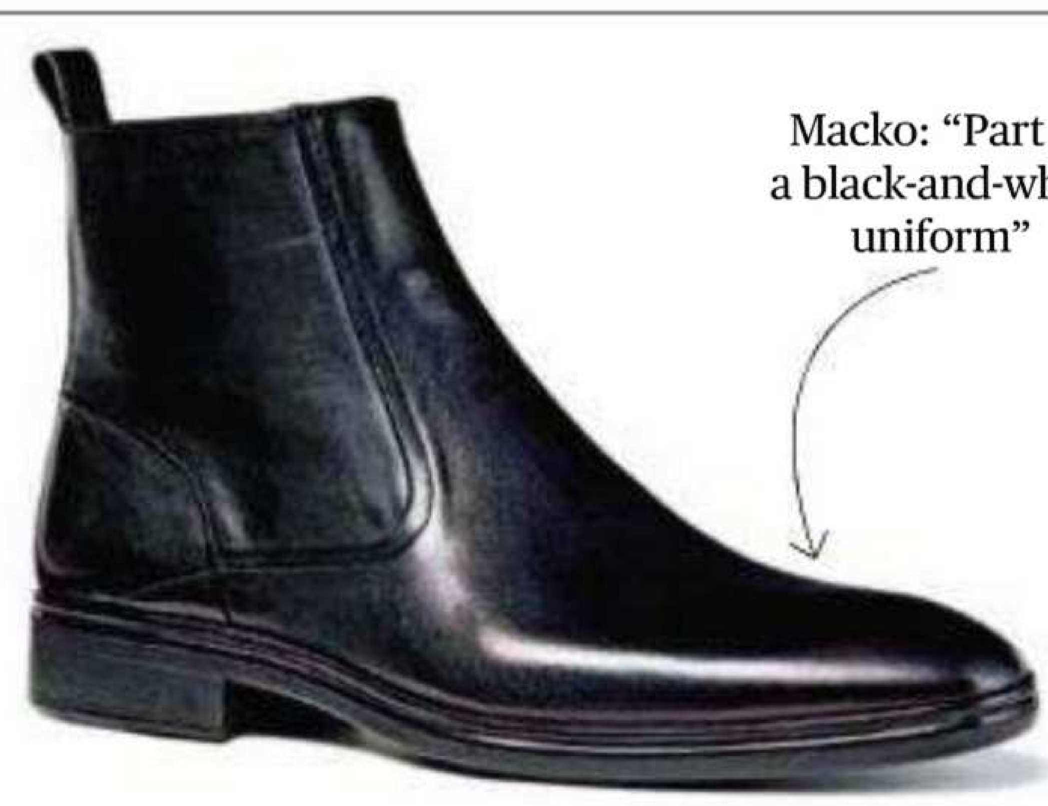


Somehow, the boat shoe has veered mainstream. Sperry's version has even been co-opted by hipsters. "He's definitely casual," Macko says. "He hasn't put any thought into his wardrobe," White argues. "Assuming he's not a sailor or in high school or college, I think it's a guy who needs a girlfriend."

Fig. 10

The Starchitect





Even if the hotshot who wears Chelsea boots is not an actual rock star, Harter says, "he feels like one." Macko, however, detects a self-disciplined streak in this mod-influenced style. "He has a design aesthetic, but he's very structured." White: "He's a little more cultured. He wears black turtlenecks."

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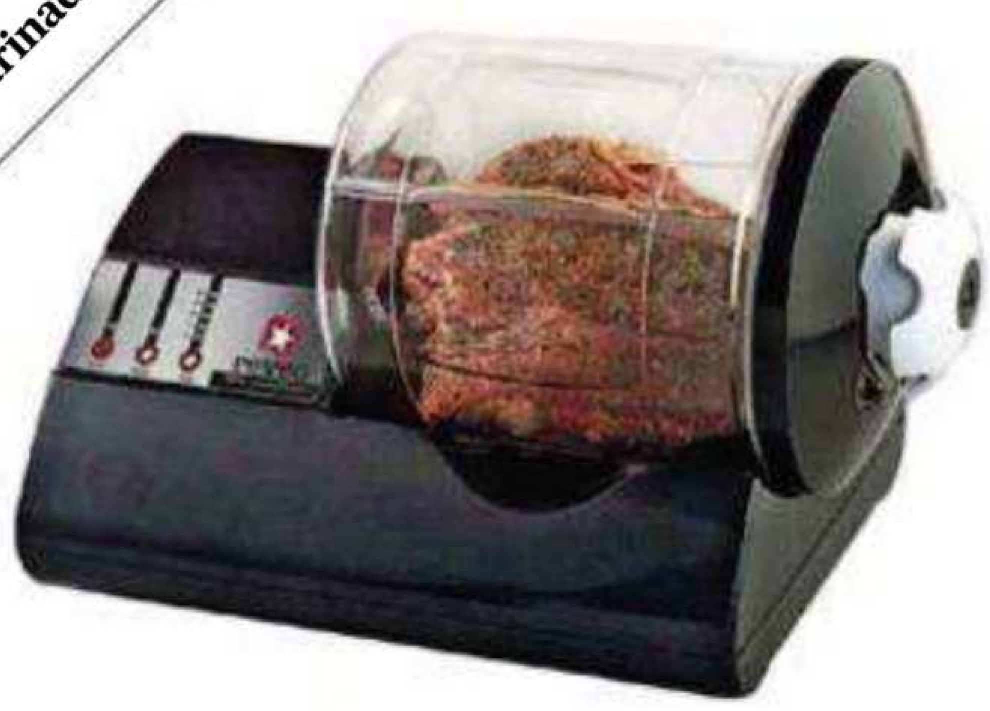


Etc. Hands On

Red Hot American Summer

The season's best grill toys

Marinader



Reveo MariVac Food Tumbler

Don't have two days to pan-soak your steak? This device tumbles meat to tenderize it while removing air to open the fibers, imparting mouthwatering flavor in just 10 minutes. *$200, chefsresource.com*

Range



Grillworks Grillery 42

On the heels of the hibachi fad comes this, the Ferrari of artisanal anti-Weber grills. A crank wheel lets you raise and lower the cooking surface to adjust for the heat of the flames, and the V-channel surface collects basting juices. *$4,475, grillery.com*

Cooler



RC Cooler

R2-D2 was nice, but did he ever deliver a cold one to Master Luke? This radio-controlled, battery-powered puppy holds 12 cans or bottles plus ice, has a 40-foot range, and rolls like a droid. *$70, hammacher.com*

Heat gauge



iGrill

This meat thermometer syncs with your iPhone or iPad so you can monitor your food without actually standing at the grill. It's for the person who has everything—or really can't cook. *$100, igrillinc.com*

Tongs



Steven Raichlen Ultimate Luma Tongs

These may look like ordinary grill tongs, but a tiny, detachable halogen flashlight enables cooks to keep flipping long after sundown. *$20, amazon.com*

Cleaner

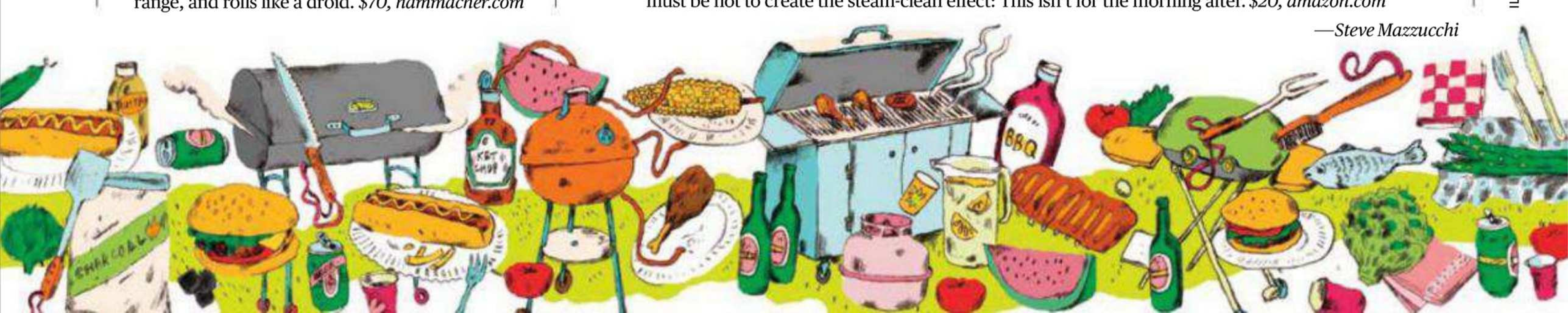


Grill Dozer Steam Cleaning Tool

This gadget's built-in pump sprays water onto the grill, while the three-sided brush clears residue. The grill must be hot to create the steam-clean effect: This isn't for the morning after. *$20, amazon.com*

—Steve Mazzucchi

ILLUSTRATIONS BY PETER OUMANSKI



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Nice Whiff

Yosh Han's custom scents capture clients' essence

Perfumer Yosh Han is best known for her Yosh fragrances sold at high-end shops. Her real passion, however, is creating made-to-order perfumes. It's a delicate process, costing $750 and up, that can take anywhere between one afternoon and three months depending on how much time a fragrance needs to aerate.

Operating out of her apartment in San Francisco, Han, 40, has clients attend a wafting session where they may smell up to 100 scents before narrowing them down to their favorites. "This is the most magical part of the process," Han says. "Each person communicates with the essences in a different manner." Then she blends the scent with top, middle, and bottom notes, all based on her mental algorithm of the client's aura and energy. The fragrances, she insists, always smell best on their owner. B

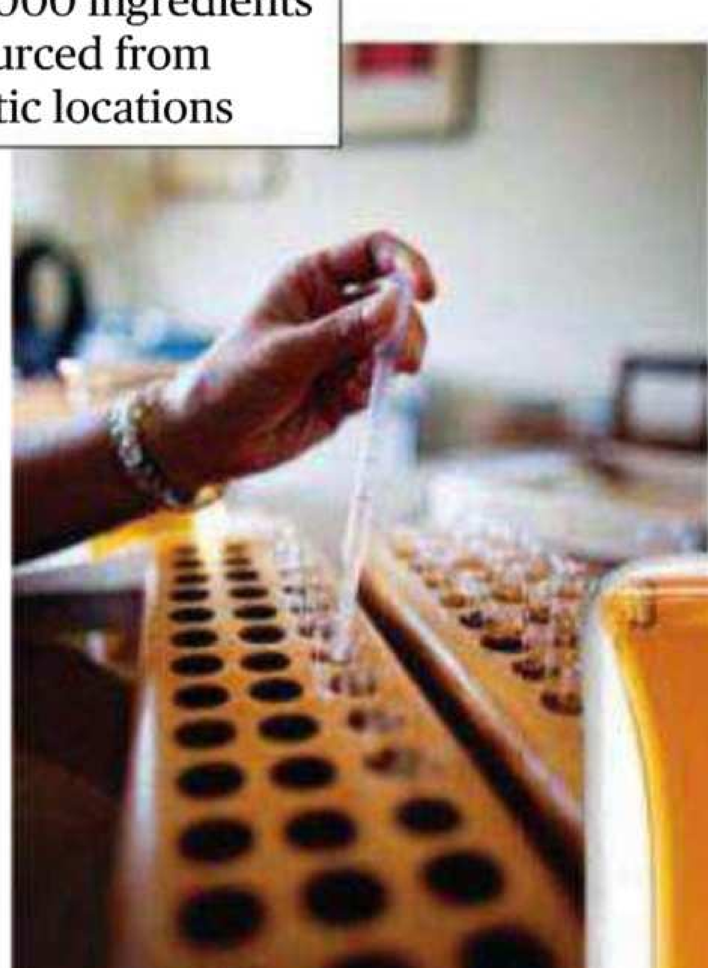
—Jean Welsh



Personalized fragrances cost anywhere between $750 and $10,000



Last year, Han created perfumes for more than 100 clients



Han's scent library holds 1,000 ingredients sourced from exotic locations



Ready-made fragrances are sold at Henri Bendel, Fred Segal, and Barneys



A notecard details the elements in Han's bespoke "Happy Juice"



Among Han's ingredients: agarwood, chocolate, guaiac wood, and massoia

PHOTOGRAPHS BY ERIN SIEGAL FOR BLOOMBERG BUSINESSWEEK (5)

WorldMags

Teaching pro Cindy Reid can charge as much as $600 per hour for lessons in China—far more than in the U.S.



Play It Where It Lies

As the U.S. golf economy shrinks, opportunistic pros are heading to China. *By Bruce Einhorn*

On a recent morning in the southern Chinese city of Dongguan, Cindy Reid—expat golf pro, aspiring brand icon—is working closely with a pupil. "Chin out, buddy!" she yells. "You are only as good as your grip, buddy! Your grip is *too strong*, buddy!" After each comment, Reid's student, Jackson, a mystified 10-year-old boy in custom-made golf clothes, turns to the young Chinese interpreter employed by Reid. The boy, the son of a local industrialist, speaks no English, and Reid, who was born in New Jersey, speaks no Mandarin. But that doesn't stop her from charging $600 per hour to help 10-year-olds swing like pros. After Jackson hits a good shot, Reid rewards him with a new nickname. "Nice job, Rocky!" she yells, as the interpreter translates. "Whenever you hit a good shot, I call you Rocky!" (The interpreter translates that, too.) Then an even more mystified Jackson gets a high five from Reid, who has a team of instructors ready to keep him busy for several more expensive hours after she's done.

U.S. golf course closures are "creating the desire to go where the money is," says one expat pro

Reid, the force behind the Cindy Reid Golf Academy, is a pioneer of the American golf-pro diaspora. Her school, which opened three years ago at the exclusive Mission Hills golf club, 45 minutes from Hong Kong, has 2,000 part-time students, more than half of whom are kids. The former Ladies Professional Golf Assn. player is now focused on opening two more schools and transforming herself into the first expat golf pro brand. Reid appears regularly on the Golf Channel China and contributes golf insight to state-owned China Central Television. She's published several golf-based articles and books in Chinese and has a team of translators working on more. Reid is also preparing to star in a new reality series, *Beautiful Golf*, that begins this week. She hopes it will help her launch Cindy Reid-branded clothing, sunscreen, DVDs, and iPhone apps. "I've got a lot to do," she says.

The ambition of China's nouveaux riches to live like American nouveaux riches has launched an irrepressible golf economy: There are now more than two dozen Chinese golf magazines; Golf Channel China broadcasts 24/7; and Shenzhen University is one of several institutions of higher learning offer-

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The Shark designed one of the dozen courses at Mission Hills, outside Hong Kong

ing degrees in golf management. Not to be outdone, Hunan International Economics University recently began a graduate program. According to the official *China Daily* newspaper, the number of golf courses in the country has more than tripled since 2004—which happens to be the same year the government officially banned the construction of new courses. (Clever developers have found loopholes in the law—such as building "country clubs" rather than "golf courses.") Mission Hills alone has a dozen courses, designed by stars such as Ernie Els and Greg Norman. Says Reid: "It's amazing what they have here."

This is very good news for the golf instruction business, which, until recently, seemed to be in decline. "The golf market in the States is hurting," says Shay Smart, an American pro who teaches in Hong Kong and China, especially "if you're at Joe Blow Municipal." This was the harsh reality facing Mike Schield, a 25-year-old from Wisconsin who studied golf management at Methodist University in North Carolina. Schield struggled to find a teaching job after graduating, and settled for a gig at a Palm Springs (Calif.) club where he worked in the pro shop and herded carts. "This wasn't how I saw my life going," says Schield, who dreamed of being a real club pro. So in late 2009 he ventured to China and landed a job at Reid's academy. "A lot of young professionals are out there, and it's very difficult for them to find a job right now," he says. "But China is just booming."

To keep up with the momentum, Reid recruits American pros through the PGA's online job listings and travels to the States to interview candidates. Still, many pros emigrate on their own. "There's a net decrease in golf courses in the U.S.," says Jeff Olyniec, a 36-year-old Alabama native who works at China's Palm Island Resort, referring to the 107 courses that closed in the U.S. last year, according to the National Golf Foundation. "That's creating the desire to go where the money is." Olyniec, who estimates there are 50 to 75 PGA pros teaching in China, expects more to follow. "Golf is still very young [here]," says Chris Marrs, 32, a British pro who is the golf director at Palm Island. "The demand will always be here for us."

And the money is pretty good—at least for a golf pro. Reid employs four Chinese teachers, but the work ethic among her local staff sometimes bothers her. "They're a little lazy once in a while," says Reid. "They get comfortable with the amount of money that they're making." Foreign pros are a better bet, she says, since Chinese students are generally willing to pay more for lessons from them. Cleveland native Harry Boyd, 26, started at Reid's academy in 2009 and made a breakthrough when some Mission Hills members decided he looked like Tiger Woods. "That helped," says Boyd, an African-American. "It honestly got people to pay attention to me." He now has an overflowing list of students and is enjoying the eminence and wealth rarely proffered on golf pros back home. Most Chinese "want to suck all the golf knowledge out of you: How do you hit so far? Why do you hit it like that?" he says. "They want to get as much information as possible."

The number of golf courses in China has more than tripled since 2004, despite government restrictions

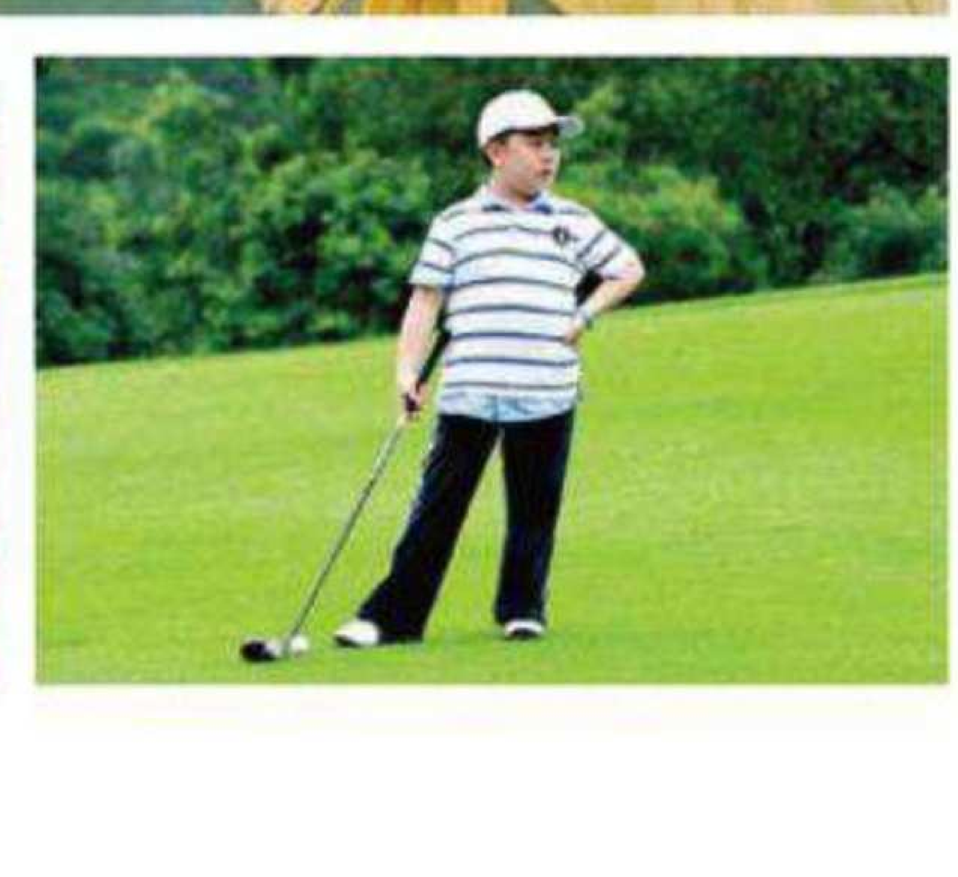
Reid hopes that sort of curiosity is the foundation of a golf-instruction empire. "In America, people sign up for six weeks [of lessons] and that's it. Here, they want 52 weeks. It's so new, they want to learn as much as they can from foreigners," she says. "They're open-minded and willing. They know they don't know it. They want your knowledge, your talent—and they're willing to pay *anything* for it." In China, her clients pay her about $150 more per hour than she was charging in the States. Reid knows that for some students, having a foreign teacher is a crucial mark of affluence. "They want to be able to tell their friends who they had lessons with," she says.

However, few émigré pros should expect to emulate Reid's success in the near future. Smart estimates that outsourced instructors might net $35,000 in their first year. Yet that figure can rise rapidly once they develop a stable of clients. In the golf-pro trade's version of the oldest profession, many instructors often hang out by the clubhouse, putting green, or driving range waiting to solicit wealthy Chinese—or at least their 10-year-old children—who have finished a round or another lesson. Yet not every pro has such patience. Reid, who currently employs four Western instructors, has seen 22 others come and go in three years. "A lot of the young guys I hire, they don't have the vision," she explains. "They're in it for the money." Ⓑ

Cindy Reid's golf instruction empire includes one school, 2,000 students, and a TV show. She hopes to soon add to that list two more schools, branded clothing, sunscreen, and iPhone apps

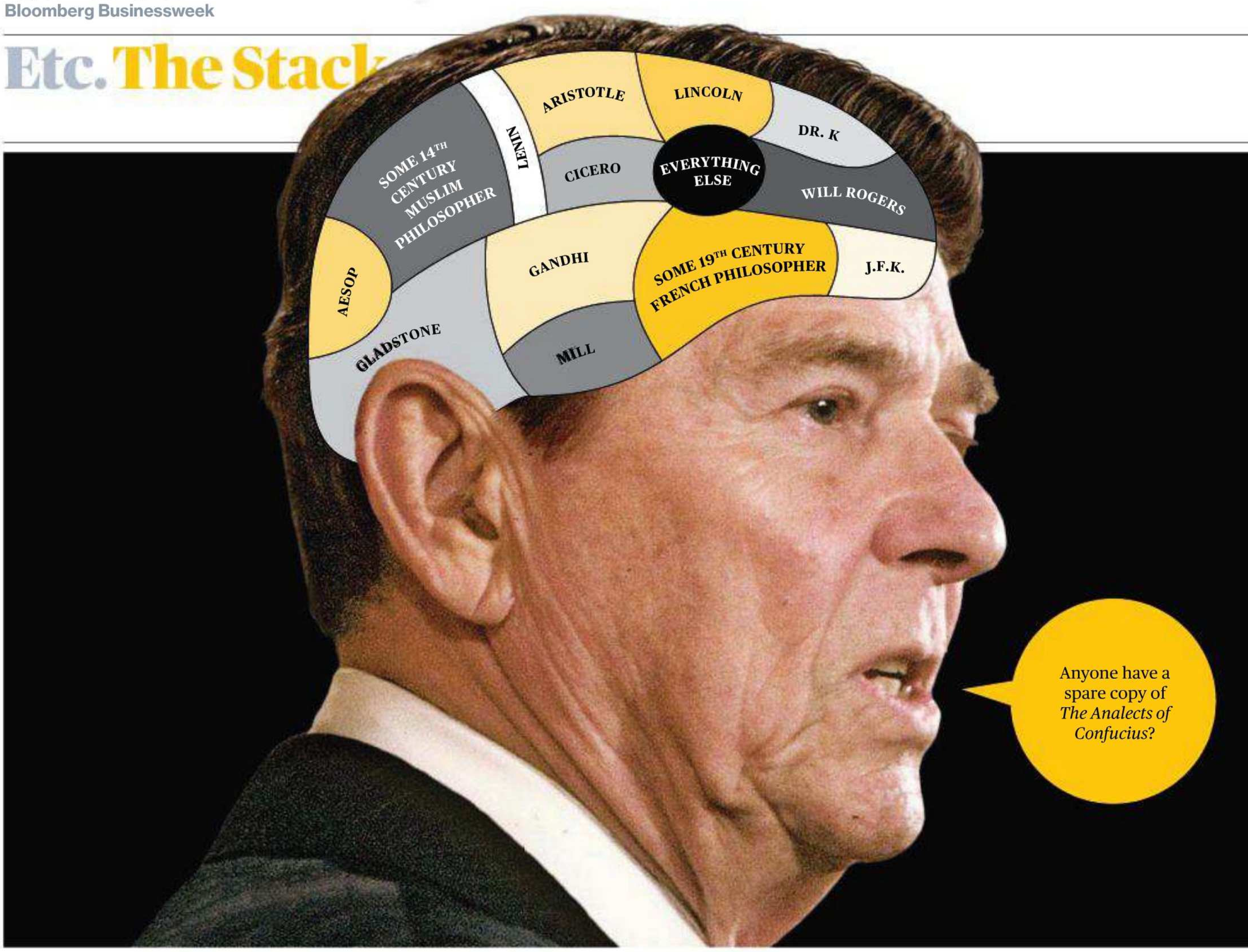






REID: PHOTOGRAPHS BY TIM PELLING FOR BLOOMBERG BUSINESSWEEK; NORMAN: GREG WOOD/AFP/GETTY IMAGES

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Inside Reagan's Brain

The Gipper's private scribbles reveal some unlikely influences

By Christopher Buckley

"The battle for the mind of Ronald Reagan was like the trench warfare of World War I: Never have so many fought so hard for such barren terrain." A dollar to the first reader who can identify the author of that line. Christopher Hitchens? Bill Maher? The editor of *Pravda*?

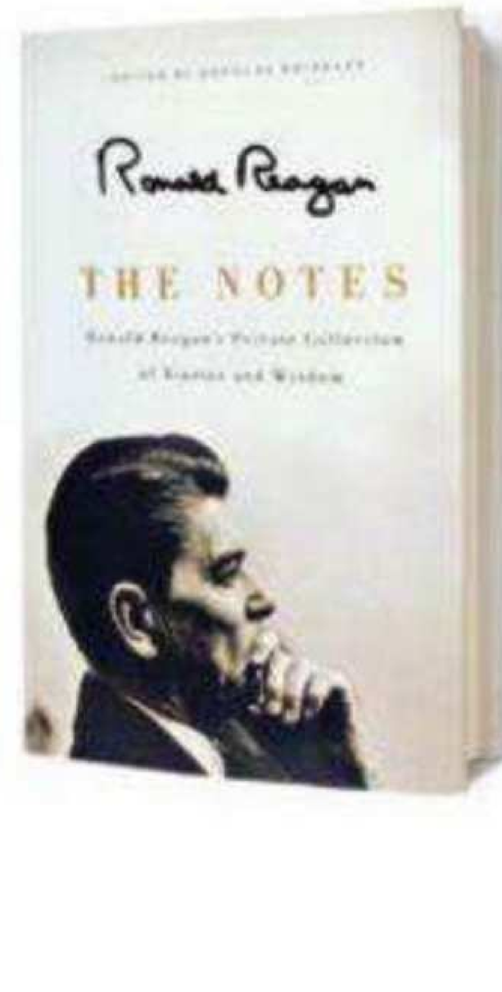
Nope—it was Peggy Noonan, in her otherwise adoring 1990 memoir of her time as one of Reagan's speechwriters. That was then. Now it's 2011, the centennial of the Great Man's birth. In recent years a profusion of books has sought to make hash of the idea that our 40th President was an "amiable dunce," as the late Clark Clifford, the Democratic presidential horse whisperer and disgraced bank scandal figure, once proclaimed him to be. At the top of this syllabus is the verbosely titled *Reagan, In His Own Hand: The Writings of Ronald Reagan That Reveal His Revolutionary Vision for America*. Then comes *The Age of Reagan*, by Steven F. Hayward, and the identically titled *The Age of Reagan*, by the left-leaning but admiring Sean Wilentz. And, most recently, *The Reagan Diaries*, edited by historian Douglas Brinkley.

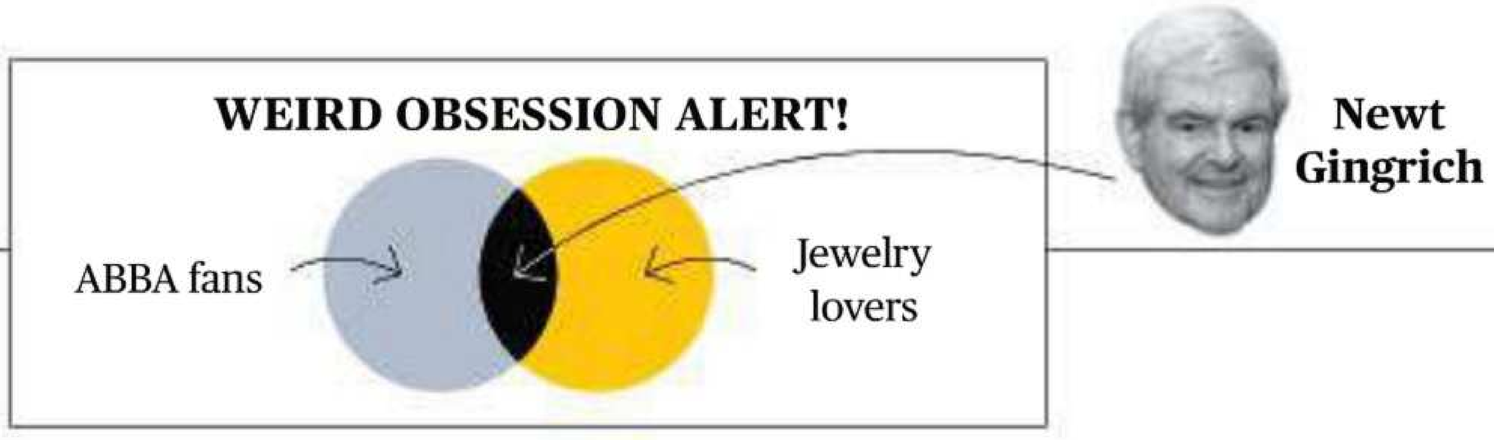
Here, again, comes the indefatigable Brinkley with this fascinating addition to the No-Dummy-He sub-genre of Reaganalia. As Brinkley explains in his introduction, *The Notes* consists of the collection of 4-by-6-inch index cards that Reagan kept in his desk—his chrestomathy, or commonplace book of wit and wisdom—all of which were written in his own "impeccable" scrawl. Brinkley speculates that Reagan began these jottings sometime between 1954 and 1962, when he was a spokesman for General Electric, and kept on amassing them after he became the most powerful man in the world. Thankfully, Iran-contra counsel Lawrence Walsh didn't know of their existence or he'd surely have subpoenaed them—and left them to languish in some government warehouse like the one in *Raiders of the Lost Ark*.

i

The Notes: Ronald Reagan's Private Collection of Stories and Wisdom

Edited by Douglas Brinkley
HARPER
320 pages; $25.99





Instead, amazingly, they languished for years in a cardboard box at the Ronald Reagan Library in Simi Valley, Calif. They were only recently discovered during a renovation leading up to this year's centennial. The library staff calls them "the Rosetta Stone," but their discovery puts me more in mind of archeologist Howard Carter's utterance, in 1922, upon first peering into King Tut's tomb and being asked what he saw. "Wonderful things," he said. Indeed, these notes—which make up Reagan's own private *Bartlett's Familiar Quotations*—are wonderful things. Witticisms, observations, apothegms, newspaper cuttings, statistics, *bons mots*—and indeed, some pretty *mals mots*—from Aristophanes to Zedong, Mao. In between is a lot of Jefferson, Lincoln, FDR, and a French politician of the 1840s whom I'd never heard of named Claude-Frédéric Bastiat. Along the way is Hilaire Belloc, Whittaker Chambers, Abba Eban, Ho Chi Minh, Ibn Khaldoun (about whom, more in a moment), Lenin, Ortega y Gasset, Pascal, Seneca, and Sun Tzu. For a dummy, Reagan was a voracious pack rat of wisdom—especially in the days before Google.

These notes provide a portal into the—dare one say, fertile?—mind of one of the late 20th century's great leaders. Two big themes run through them: a) the imperilment of individual liberty by growth of state power; and b) the oppressive taxation that the leviathan demands. In other words, as Goldwater once put it—though it's strangely not included here—"A government that is big enough to give you everything you want is also big enough to take it all away." Yet many of the sources that *are* included prove surprising for a so-called right-wing ideologue such as Reagan: "Every time that we try to lift a problem to the govt., to the same extent we are sacrificing the liberties of the people." Irving Kristol? Actually, JFK. "Strike for the jugular. Reduce taxes and spending. Keep govt. poor and remain free." Jack Kemp? Nope. Justice Oliver Wendell Holmes Jr.

I'll bet anyone another (aftertax) dollar they won't guess the provenance of this one: "At the beginning of the dynasty taxation yields a large revenue from small assessments. At the end of the dynasty taxation yields a small revenue from large assessments." Who knew that Ibn Khaldoun, identified by The Gipper as "Moslem Phil. 14th Century," anticipated the Laffer Curve by 700 years? (Not me.) Reagan's delight in witticisms, never much in doubt even among his detractors, is also on full display here. The section titled "Humor" is the book's longest. My favorite is the "Chinese Proverb, 400 B.C." that proclaims, "When the music of a nation becomes fast, wild & discordant it shows the nation is in confusion." Could Reagan have come across this one after his first exposure to Janis Joplin? Or the dulcet arpeggios of Meat Loaf singing *Paradise by the Dashboard Light*?

Alas, Brinkley does not tell us when Reagan found this one or, for that matter, any of the notes. It's possible that there is no way of knowing, but even so, *The Notes* is deplorably lacking in footnotes. There is a glossary at the back that will tell you who in the world ... Ibn Khaldoun was. (Answer: A forefather of social science in the East, and, as the The Gipper noted, something of a philosopher.) Or Claude-Frédéric Bastiat. (An early 19th French political economist known for his clever attacks on certain state policies.) Many of the notes cry out for more notes—unless, for instance, you already know why Harrison Gray Otis of the *Los Angeles Times*, circa 1910, was such a stinker. (It's a long story.)

Brinkley's introduction is pleasant and informative but also marred by sentences such as: "The reader gets the impression that Reagan is a redwood tree and these are the decorations of his own philosophy, the ammunition that he will need to survive the hustings ahead." O.K., if you insist. But surely the "U.S. federal government" is a wee bit tautological; and—not to nitpick—was James A. Garfield technically "assassinated on July 2, 1881" if he actually died months later on Sept. 19? *The Notes* would have been a richer book had its editor invested more effort. Brinkley, a protégé of the late Stephen Ambrose, is a humblingly prolific writer. How many historians are capable of writing a biography of Dean Acheson and editing the letters of Hunter S. Thompson? The man must sleep only one hour a night, but to quote the song, "Slow down, you move too fast."

Still, as we used to say during Watergate: This is a dandy little volume. It may also be an important one. Much has been said and written about Reagan's enigmatic, elusive personality. And, true enough, Reagan has been, and may yet remain, a puzzle to his biographers and critics. Although a few recent books have proclaimed to have finally uncovered the *real* Reagan, there's a chance we'll never get any closer than in these scribbles, which reveal so much about a curious mind, glad soul, and warm heart. They reveal him to be a man who had known sorrow and defeat but who, by dint of indomitable cheer, gentlemanly grace, and extraordinary energy overcame those obstacles—to say nothing of an evil empire—and always kept his smile. And his wit. As Reagan jotted to himself: "An underdeveloped Nation—that's one Henry Kissinger hasn't visited yet." Or, in a line that may inspire the next gusher of Reaganalia, "When a woman loves a man he can get her to do most anything she really wants to." B

Going Dutch

Some of the former President's unlikely sources of inspiration



On communism:

"It is possible that if Mao ... [and] Ho Chi Minh had not borne the title of Communist but otherwise had done exactly what they have done in their 2 countries, we would have accepted their victories over their domestic rivals & lived with them in peace."
—Senator J. William Fulbright



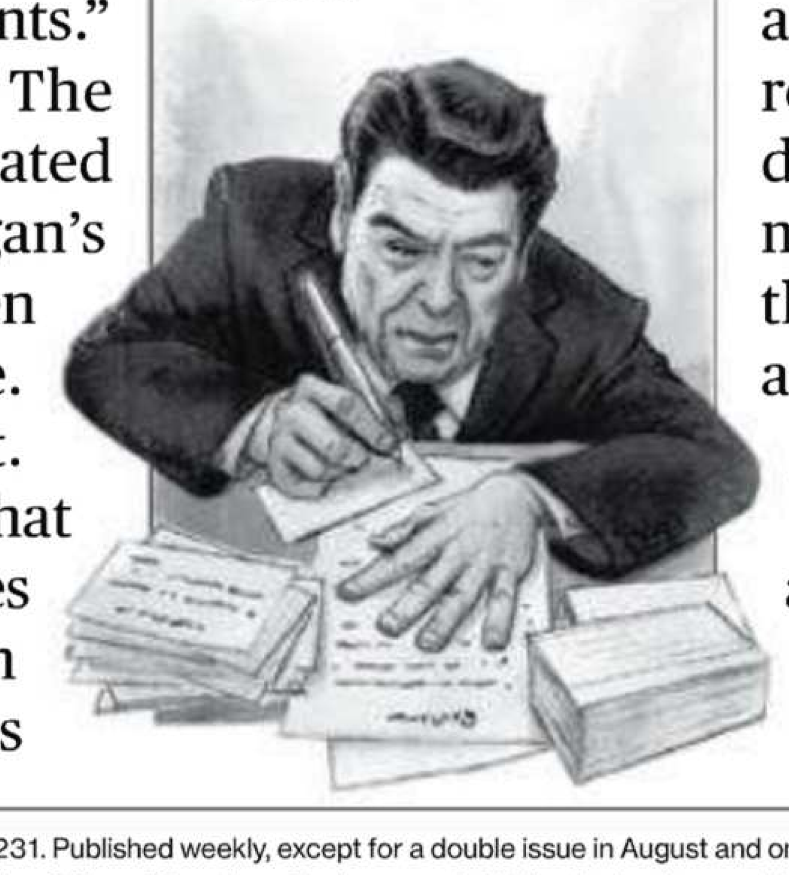
On Congress:

"A rebuke to Cong. 'How could it be otherwise in a body to which the people send 150 lawyers whose trade it is to question everything, yield nothing & talk by the hour.'"
—Thomas Jefferson



On Dr. K:

"An underdeveloped Nation—that's one Henry Kissinger hasn't yet visited."
—Anon.



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Bloomberg Businessweek (USPS 080 900) May 30-June 5, 2011 (ISSN 0007-7135) T Issue no. 4231. Published weekly, except for a double issue in August and one in December, by Bloomberg L.P. Periodicals postage paid at New York, N.Y., and at additional mailing offices. Executive, Editorial, Circulation, and Advertising Offices: Bloomberg Businessweek, 731 Lexington Avenue, New York, NY 10022. **Postmaster:** Send address changes to Bloomberg Businessweek, P.O. Box 8418, Red Oak, IA 51591-1418. Canada Post Publication Mail Agreement Number 41989020. Return undeliverable Canadian addresses to DHL Global Mail, 355 Admiral Blvd-Unit4, Mississauga, ON L5T 2N1. Email: bwkcustserv@cdsfulfillment.com. QST#1008327064. Registered for GST as Bloomberg L.P. GST #12829 9898 RT0001. Copyright 2011 Bloomberg L.P. All rights reserved. Title registered in the U.S. Patent Office. Single Copy Sales: Call 800-298-9867 or email: busweek@nrmsinc.com. Subscriber Services: Call 800-635-1200 or log onto our website: http://www.businessweek.com/custserv/manage.htm. Photocopy Permission: Where necessary, permission is granted by copyright owner for those registered with the Copyright Clearance Center (CCC), 222 Rosewood Drive, Danvers, MA 01923 or email the CCC at info@copyright.com. Custom Reprints: For customized bulk reprints of Bloomberg Businessweek articles, contact The YGS Group at 800-360-5549 or email: businessweekreprints@theYGSgroup.com PRINTED IN THE U.S.A.

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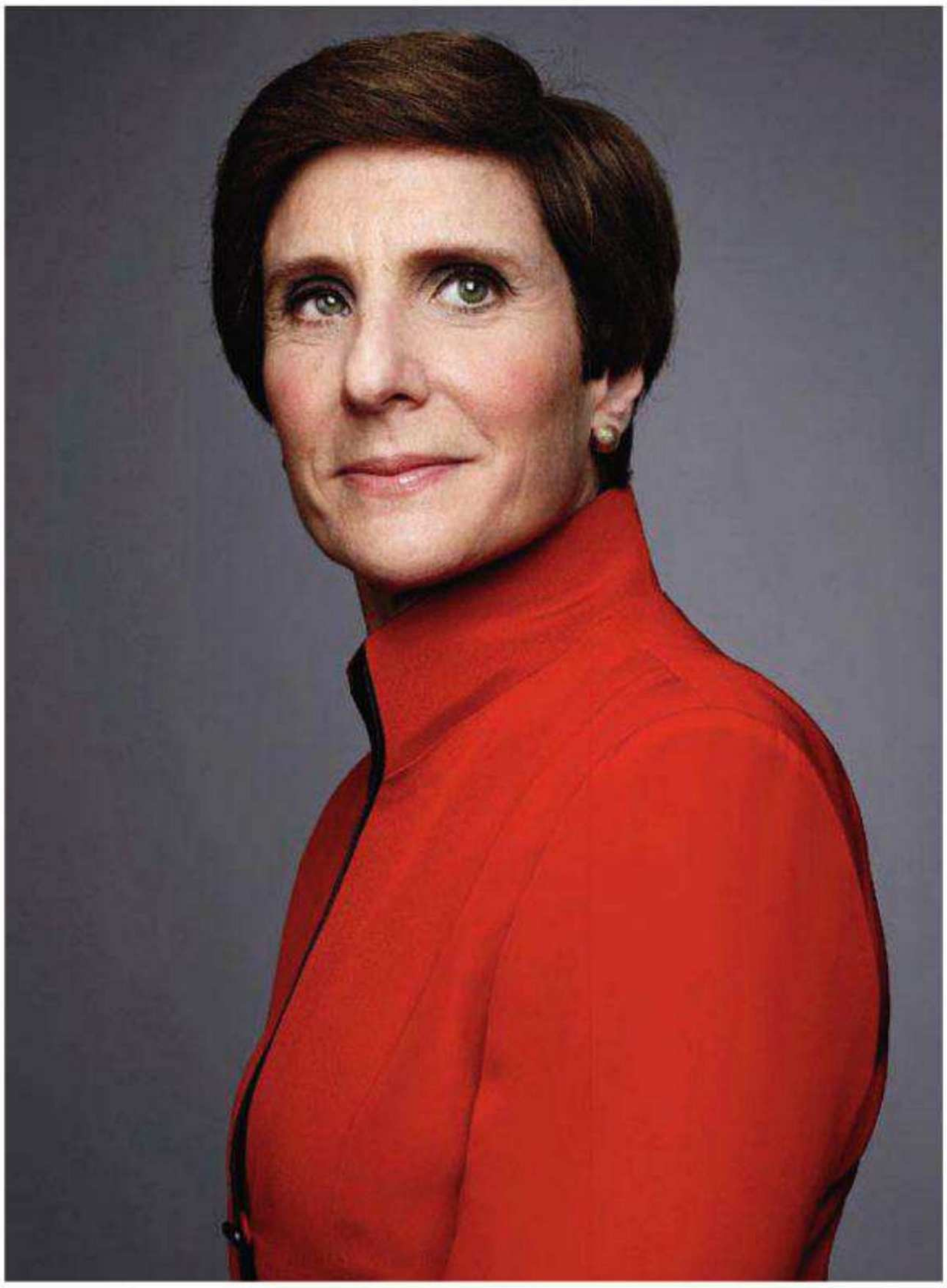
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Irene Rosenfeld

"It's tempting to get distracted by a lot of the theater that goes around. One has to have a rather thick skin when you sit in a role like mine"

Kraft's chief on her refusal to let U.K. lawmakers publicly grill her about the company's $19 billion hostile takeover of Cadbury



Cadbury was a compelling strategic opportunity for us, but I knew there were enormous sensitivities. It was a hostile transaction. It was a transatlantic takeover of an iconic U.K. brand. Shareholders like Warren Buffett expressed concern that we were using stock. There was a public outcry. I had hoped it would be a friendlier transaction, but the challenge was that the target wasn't anxious to be acquired.

We spent a lot of time thinking about how best to approach all stages of the deal. When we were asked to appear before a U.K. parliamentary committee, I made the decision that only those closest to the business should go. I didn't feel there was a need for me to attend. We had answered all their questions; there was no new information. We'd met with lawmakers and addressed these issues. I've spent a lot of time in the U.K. with the folks that really matter to me, employees and other constituents. Appearing before the panel was not the best use of my personal time.

I've been surprised by the extent of the coverage around that decision. Public relations are critically important to Kraft; I care greatly about how our shareholders, our employees, and our consumers feel about this company. But we need to be selective in addressing concerns. As we accomplish our objectives, a lot of concerns will fall away. There's been a lot of hype, and one of the challenges with the U.K. media is that they're not always accurate.

It's tempting to get distracted by a lot of the theater that goes around. One has to have a rather thick skin when you sit in a role like mine. At the end of the day, one of the strengths of women is our willingness to not get bogged down with political distractions and manage for the long term. My main criterion is whether I'm doing right by my shareholders. We're honoring and, in many cases, exceeding our commitments. Even Warren sees the value for the overall performance of Kraft. Ⓑ

—As told to Diane Brady

PHOTOGRAPH BY MIKE MCGREGOR FOR BLOOMBERG BUSINESSWEEK

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